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Charles Stephen Kimei

Tanzania's Financial Experience in the Post-War Period

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Studia Oeconomica Upsaliensia 13

John S. G. Jones

Tanzania's Financial Expenditure
in the Post-War Period

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ABSTRACT

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In this study, three dimensions of the financial market are distinguished: widening—the growth in the number of actors in the market, lengthening—the growth in the number of financial instruments, and deepening—the increase in the value of total financial assets relative to national income (or Gross Domestic Product, GDP). It is argued that changes in these dimensions depend on whether finance is unrestricted or restricted. A thesis of unrestricted versus restricted financial regimes, and their implications for widening, lengthening and deepening is presented.

Based upon this thesis Tanzania's post-war financial experience is discussed. It is hypothesized that, depending on the type and extent of regulation, the post-war financial experience may be divided into two sub-periods: prior to the formation of a national central bank and the nationalization of the banking system (1950—65), and thereafter (1966—80). The financial growth of the country during each of the sub-periods is studied separately, and then compared to each other.

The main line of approach has been to study the sources and use of funds by the various financial institutions that operated in the country. In doing this, the idea is to establish the extent of widening and lengthening in the financial sector, as well as the degree of deepening in the various financial intermediaries—measured by the ratio of the financial assets of the respective institutions to Gross Domestic Product (GPD). The money supply aspect is emphasized, which is natural given the fact that money supply (M1) constitutes up to about 80 % of the financial assets in Tanzania.

It is shown that there was substantial widening and lengthening of the financial sector during 1950—65, but this qualitative change was not associated with deepening. The period 1966—80 was, on the contrary, one of limited specialization, but with fast growth of total financial assets relative to GDP. The growth of financial assets during this time was mainly due to an expansion in the money supply.

By studying the development of money supply, it is found that monetary expansion was mainly due to increasing public sector deficits — especially those of the parastatals—after the Arusha Declaration of 1967.

The study winds up with a summary assessment of the financial development during the two periods studied. It is concluded that during both 1950—65 and 1966—80, Tanzania experienced financial restriction but in the latter period this was supplemented with crowding-out. The might be the main reason why financial growth was limited to specialization during the first sub-period and to growth of the money supply in the second sub-period.

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To my Wife
Rose Lauheri Killenga
For Her Love and Support

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Charles Stephen Kimei
Dar Es Saalam, 19 January 1986

Introduction

Introductory Remarks

In the current economic literature, there is consensus that financial growth—characterized by an increase in the number and variety of financial institutions and a substantial rise in the ratio of total financial assets to gross national product (or tangible wealth)—is a necessary condition for rapid economic growth.¹ Of most importance is probably the relationship of the stock of financial assets and liabilities to the real capital stock (Patrick (1966)). The development of this ratio is directly and strongly correlated with real output growth.²

The emergence of this consensus, coupled with the general recognition that in the Less Developed Countries (LDCs), scarcity of capital is probably the most limiting factor to economic growth,³ has aroused special interest among students and researchers about the role of the financial system in the economic development of the LDCs. Moreover, policy-makers have lately shown particular concern about understanding the interaction between the financial structure, monetary policy and economic development.

My ambition to study the financial experience of Tanzania has generally been motivated by the above interests, and by my work in the country's central bank—the Bank of Tanzania.

¹ The argument originated with the work of Schumpeter (1949), and was later taken up by a number of authors, including Gurley and Shaw (1955, 1956), Gerschenkron (1962), Goldsmith (1969), Adelman and Morris (1967), Cameron (1967), McKinnon (1973) and Shaw (1973).

² The role of capital in economic growth is recognized by almost all economists, and most of the growth models that have been designed include capital as a crucial input. See, for example, Harrod (1948) and Domar (1957).

³ See, for example, Thorwall (1974, Ch. 1).

Purpose of the Study

Despite the recognition of the role of finance (and the financial system) in the economic development of Tanzania,⁴ little attempt has been made to study the experience of the country's financial system in the recent past.⁵ Nonetheless, such a study seems crucial, both as a starting point towards recommending an appropriate financial development strategy, and for other research dealing with finance and development in Tanzania.

This study is intended to fill the gap. Its main objective is to document the financial experience of Tanzania and address the factors that have affected the development of the financial system especially during 1950—80. Emphasis on the period beginning from 1950 is motivated by the fact that modern financial institutions in Tanzania grew rapidly only in the post-war period, and the few institutions (mainly commercial banks) that had emerged in the earlier period were poorly documented (see, Lomoro (1965)).

The period 1950—80 is here broken up into two sub-periods: 1950—65 and 1966—80. The first sub-period is characterized by a high degree of monetary openness of the economy (see, chapter 1), absence of a national central bank, and little government interference in the financial market. The second sub-period is featured by the existence of a national central bank (from 1966), the nationalization of the financial system in 1967, and an ever increasing role of the government in the financial system.

My analytical framework for discussing Tanzania's financial experience follows that of Gurley and Shaw (1955, 1956), Goldsmith (1969), McKinnon (1973) and Shaw (1973). According to these authors, the development of the financial sector, as a whole or some of its institutions, may be said to have three dimensions: width, length, and depth. Financial widening may be defined as growth in the number of actors in the financial market—including savers, investors and specialized financial intermediaries. Financial lengthening involves growth in the number of types of financial instruments (or assets) offered by the financial system. Lengthening and widening are therefore very much inter-related as the diversification of the intermediaries would almost necessarily entail a diversification of instruments. Finally, deepening of finance may be defined as growth of total financial assets offered by the sector (or its respective institution) relative to growth in national wealth (or its proxy—usually the national income).

⁴ This recognition is partly reflected by nationalization of the banking system immediately after the Arusha Declaration in 1967, as one of the main 'commanding heights' of the economy.

⁵ Clara Caselli's (1975) monograph is the only comprehensive attempt that has been made. However, the monograph is purely descriptive and does not analyse the problems involved in the course of financial growth in Tanzania.

With a view of assessing the development in the degree of widening of the financial sector in Tanzania, this study will attempt to discuss as many of the institutions that operated in the sector during the period under review as the available data will allow. However, a discussion of the financial institutions *per se* may say nothing about the extent of widening and lengthening, unless supplemented by proof that new financial intermediaries offer specialized financial assets and liabilities that were not offered by the existing institutions.⁶ For this reason, the discussion of the various financial institutions in Tanzania will centre on their sources (i.e. liabilities) and uses (assets) of funds.

As will be evident from the discussion in chapter 1, financial institutions intermediate in the external financing of the non-financial sector. Generally speaking, in the intermediation function, the financial institutions raise funds from the surplus spenders (savers) in three main ways.

The first of these sources is the direct deposits they mobilize from current saving. The second source is borrowing, both from domestic and foreign institutions, and the third is grants. The latter may be obtained from domestic institutions (particularly the government) and from external donors. Each financial intermediary then invests (usually by lending) according to its specific financial speciality.

Thus, in the discussion of the various institutions in Tanzania, the main task will be to trace the contribution of the three sources of financing discussed above, as well as the specific use of funds by each institution. Of particular interest, among financial assets, are deposits of the non-financial sectors with financial intermediaries. The ratio of deposits to GDP will be used as a measure of the degree of savings mobilization—the most important function of financial institutions. Where data are available—especially for the main institutions—I shall try as much as possible to display them in tables of similar design for easy reference of interested readers.

Apart from statistical data limitations, the basic limitation of this study relates to the failure to study thoroughly the informal financial sector of Tanzania. It is assumed that financial development leads to a faster growth of the formal financial sector, and to decline in the informal sector. In contrast, financial 'disintermediation' most likely leads to an increasing share of the informal financial sector. Thus a detailed study of the developments in the informal sector would have properly supplemented our assessment of the degree of development of the formal finance sector in various periods. However, data limitations, and the absence of any previous studies of that sector in Tanzania, made a full treatment here impossible.

⁶ It may of course also happen that existing financial institutions diversify the type of financial assets they offer to the non-financial sector.

Lay-out of the Book

The remainder of this book is organized into three parts, containing nine chapters. Part one, including chapters one and two, sets the problem. Part two, containing chapters three up to seven, provides the evidence of a restricted financial growth with respect to Tanzania. Finally, part three, including chapters eight and nine, provides some evaluation of the evidence and draws some general conclusions.

Chapter one starts with a theoretical discussion of the role of financial intermediation in the mobilization and allocation of savings. Here, the main concepts are also defined. The chapter continues by distinguishing between non-restricted and restricted financial regimes, and discussing their major features. At the end of the chapter, it is hypothesized that Tanzania's financial experience during the post-war period may best be analyzed within the framework of a restricted financial regime.

Chapter two introduces Tanzania's economic setting by giving a brief analysis of those main developments in the real economy that might have had a direct or indirect connection with financial development during the period 1950—80. Among the issues addressed in this chapter are Tanzania's economic structure, the monetization of the economy, growth performance, balance of payments, aggregate investment and savings, as well as the inflationary experience during 1950—80.

The presentation of the empirical evidence for the proposed thesis starts in chapter three. This chapter describes the transition to central banking in Tanzania. It starts with a discussion of the East African Currency Board, which was the sole currency issuing authority in East Africa during 1920—65, and winds up with discussing the reason behind its dissolution and the formation of separate central banks. The chapter concludes by noting that the Currency Board was partly responsible for the slow growth of the money to GPD ratio—a measure of monetary/financial development.

Chapter four discusses Tanzania's financial experience during 1950—65. The main financial institutions in Tanzania during 1950—65, i.e. commercial banks, agricultural credit institutions and the Post Office Savings Bank, are discussed in detail. The rest of the financial institutions operating in the country during that period are described only briefly. An important conclusion deriving from the analysis in this chapter is that during 1950—65, the financial system acted mainly as a mechanism for channelling funds abroad.

Chapter five addresses central banking in Tanzania. Here, the experience of the Bank of Tanzania in conducting its major functions—issue of currency, banker to government, banker to financial institutions, issue of monetary policy and management of foreign exchange—is described. The experience of the Bank of Tanzania (BOT) is broken up into two sub-periods, 1967—70 and

1971-onwards. It is argued that in the first sub-period, the BOT operated more or less like any other central bank, with the degree of autonomy that it needed to conduct discretionary monetary policy. In the second sub-period, however, financial planning on an annual basis replaced discretionary monetary policy. The chapter concludes by observing that the BOT operated, during 1970—81, with a schedule of negative *real* rediscounting rates.

The sixth chapter is devoted to commercial banking after the Arusha Declaration (1967—80). Here, the performance of the national Bank of Commerce (NBC)—which became more or less the sole commercial bank in the country after the nationalization of the banking system in 1967—is discussed in two phases. It is argued that in the first of these phases, 1967—70, the NBC operated like a usual commercial bank, trying to maximize its profits. In the second sub-period, 1970—onwards, the public sector replaced the private sector as the major clientele of the NBC, and the bank ceased to operate as a 'usual' commercial bank, at least *de jure*.

Chapter six concludes by noting that the NBC operate with a schedule of low (and mainly negative) real interest rates on both deposits and loans, implying that it could not have been efficient in the mobilization and deployment of savings in the country during 1967—80.

The development of non-bank financial intermediaries in Tanzania during 1967—80 is described in chapter seven. This chapter mainly focuses on the sources and uses of funds for the three development banks—the Rural Development Bank (TRDB), the Industrial Bank (TIB), and the Housing Bank (THB)—as well as for the sole Insurance Corporation (NIC), the pension schemes, and the Post Office Savings Bank (POSB). It is maintained that in Tanzania, the parastatal holding companies, including the National Development Corporation (NDC), are 'quasi-financial' institutions, which have to be included in the list of institutions under the control of the central bank. The main idea in the chapter, as in the preceding two, is that the financial institutions failed to mobilize and allocate resources as efficiently as might have been possible, due to the negative real deposit and loan rates of interest. Moreover, a large part of the resources of these institutions was, according to the annual financial plans, allocated to the government and/or parastatals.

A summary evaluation of the empirical evidence presented is attempted in chapter eight which deals with the money supply process in Tanzania during 1967—81. This chapter provides a sort of aggregate view of the developments in the monetary system of Tanzania—the central and the commercial banks combined, which accounted for up to 80 % of total financial assets in 1980 (see Table 7.0). By applying the money multiplier framework, it is shown that during 1967—81, the money supply process was mainly influenced by rapid growth of public sector deficits. It is then argued that the financing of the public sector deficits through monetary expansion caused relatively high rates of inflation,

especially towards the end of the 1970s and early 1980s.

Related to the issue of inflation, and to the question whether or not domestic financial assets were more or less attractive to savers than foreign assets, is the exchange rate of the Tanzanian currency (the TZS). This issue is taken up at the end of chapter eight. It is shown that the TZS was greatly overvalued (implying that foreign assets were priced cheaper than would have been under free market) particularly from 1978 onwards. It is posited that the overvaluation of the TZS had a contractionary effect on the money supply, without which the rates of monetary expansion (and probably, inflation) recorded in Tanzania would have been much more pronounced.

The concluding chapter nine is intended to give a brief aggregate assessment of financial development in Tanzania during 1950—80 and to examine to what extent the evidence presented supports the general hypotheses and statements, formulated in Part I. The developments in the financial structure during 1950—65 and 1966—80 are first discussed separately and then compared. This comparison is important because it shows the extent to which increased government interference with the financial market (1967—80)—in particular the financing of the soaring budget deficits—may have affected the development of financial intermediation in the country.

Chapter nine ends with a summary of conclusions and policy implications.

Part One:
The Problem

Chapter One

The role of finance in the development of Tanzania

1.1 The Financial System

1.1.1 Financial Intermediation

The role of the financial system may be understood by taking a disaggregated view of the economy. The economic units making up the economy differ by their initial endowments, abilities, skills and expectations. Different economic units are therefore likely to have varying production possibilities, time preference and attitudes toward risk. As a result, the behaviour towards saving the investment may differ widely across the economic units.

In the absence of lending and borrowing among the economic units, the expenditure of each unit will be confined to its income. In other words, saving and investment decisions would have to be closely tied, as a unit can not invest prior to saving, nor save more than it invests due to absence of an external outlet for excess savings. This, so-called self-financing of investment (Gurley and Shaw (1955)), has a number of limitations. First to the extent that the distribution of investment opportunities across economic units differ from the distribution of savings among them, self-finance causes an inefficient allocation of resources by permitting relatively inferior projects to be undertaken in some units while superior ones remain without funds in other units. Second, the constraint of self-finance may bias investment towards low productivity technology, mainly because of indivisibility and bulkness of improved technology. Third, in the absence of own investment opportunity, some economic units may have little incentive to save.

The introduction of the possibility for financing deficits and using surpluses beyond the confines of an individual economic unit, that is external finance, opens a way for saving and investment decisions to be made independently. Thus, some economic units may save more than they are willing to invest on their own. These may be called savers, or net lenders. Other units may desire to invest more than they save, and may be called investors or net borrowers.

External finance may take two forms. First is the direct form, in which the investors issue their debt (direct debt or primary securities) directly to the savers. This form of financing has two main limitations: The main limitation of direct

finance is the large amount of information and costs necessary for each individual unit to evaluate the risks of the primary securities issued to them. Moreover, there is the double coincidence problem, posed by the need for a borrower with primary securities of specific attributes of liquidity, yield, safety and divisibility to find a saver desiring a similar combination of characteristics.

The second form of external financing is the indirect form, via specializing financial intermediaries. The latter solicit loanable funds by issuing the debt (indirect debt) to the surplus units or savers. These funds are then used by the intermediaries to purchase primary securities from deficit units or borrowers. The process of channelling funds from surplus to deficit units is called financial intermediation.

Thus, financial intermediation creates the indirect asset with specific combination of the risks in yield, liquidity, divisibility and safety, and at the same time provide a specific type of utility. For example, money provides utility as a means of payment, claims of life insurance companies provide a cover against misfortune, and so on. The reward to intermediation results from the difference between the rate of return on primary securities held by the intermediaries and the interest or dividend they pay on their indirect debt (the specific financial assets). Financial intermediaries may be divided in to two main groups: the monetary system and the non-monetary intermediaries. The monetary system intermediates by purchasing primary securities and creating money (as indirect debts). It also performs the role of administering the payments mechanism by transferring deposit credits on its ledgers between savers. Non-monetary intermediaries perform only the intermediary role of purchasing primary securities and creating non-monetary financial assets in the form of savings deposits, shares, equities and other obligations.

Financial intermediation overcomes the limitations imposed by self finance and direct finance. First, intermediation tends to unify the market for loanable funds (i.e. the capital market), thereby enhancing efficiency in the allocation of scarce savings. Second, the widening of investment opportunities tends to increase the average rates of the return to saving, and hence the saving rate.¹

Moreover, by exploiting economies of scale in lending and borrowing, financial intermediaries are capable to offer assets that are more attractive to savers, in terms of yield, liquidity, safety and divisibility.² To the extent that such

¹ Assuming that the income effect of the increase in rates of return to savings is weaker than the substitution effect. For more discussion of this, see for example, Galbis (1982).

² On the lending side, economies of scale may be derived from the management of investments in primary securities, reduction of risk through diversification, and the possibility for reducing the risks of illiquidity by scheduling maturities. On the borrowing side, the large number of depositors allows the institutions to get along with a portfolio that is relatively illiquid (see Gurley and Shaw (1960, p. 194)).

assets are of a wide variety and highly specialized, financial institutions stimulate savings from a wide spectrum of savers, and this might imply a higher level of aggregate savings.

Further, by unifying the market for loanable funds, financial intermediation may reduce the effective rate of interest for each type of investment and hence the cost of investment, thereby giving incentives to investors. Intermediation may also enhance increased monetization of subsistence sectors. This will in turn encourage commercial production with attendant increases in output due to specialization (see Chandavarkar (1977)).

It may also be mentioned here that financial intermediation paves the way for an active conduct of monetary policy in an economy. Such policy requires that the government (or its agent acting as a monetary authority) be capable of influencing the supply of money—and thus prices—in order to affect aggregate demand. This is possible provided that the economy is closed (in the sense of being insensitive to external shocks) and has well developed financial markets. This is further discussed below.

1.1.2 Money and Capital Markets

The financial markets are often together referred to as the “credit market”. The credit market may be said to have three main structural dimensions: width, length and depth. The width of the market may be measured by the number of actors in it, i.e. the number of savers, investors and financial intermediaries. An increase in the number of these actors may be termed financial widening.

The length of the market may be defined in terms of the number of different instruments or financial assets traded in it. Among these instruments are currency and demand deposits, savings and time deposits, insurance and pension claims, loans by financial intermediaries, mortgages, government debt, corporate bonds and corporate stock, trade credit and other claims.

Widening and lengthening of a financial market are, in practice, closely related. Thus, for example, due to the specialized character of financial intermediaries, it might be impossible to have an increase in the number of financial assets (lengthening) without an increase in the number of institutions.

Both widening and lengthening, taken singly, may imply deepening—which I define as the growth of the value of financial assets relative to income or national wealth. However, the possibilities for deepening are broadened when both widening and lengthening are in action.

The credit market involves financial instruments which differ in terms of marketability and market risk, i.e. liquidity. This spectrum of financial instruments can be roughly divided into two groups—money and capital assets. Money is the name used for fully liquid assets, which can be immediately marketed without taking any market or price risk. These are the properties

which make money useful as a medium of exchange and for transaction reserves and makes possible the transformation of a barter economy into a market economy.

Marketability means that there must be efficiently working second-hand asset markets. This condition is fulfilled almost by definition for notes and demand deposits but far less certain for other money market instruments like time-deposits, commercial bills and other short-term debt certificates. For this reason a narrow definition of money supply only includes notes and demand deposits together with foreign currency reserves and centrally held reserves of the financial institutions.

The second condition—the absence of market risk—requires an efficient and generally trusted market maker for monetary assets—what we could call a fiduciary authority—which serves as a guarantee of the price of monetary assets. Usually this function is fulfilled by a note-issuing central bank, which also serves as a lender of last resort for the other banks and financial institutes, thus supporting peoples trust in the credit instruments marketed by these institutions. The central bank usually also serves as the government's bank, financing public budget deficits, if and when they occur, and as central deposit of foreign currency reserves.

The operations of the central bank will have a decisive influence on the monetary supply both through the direct creation of money involved in financing public budget deficits or in buying bonds from other financial intermediaries and by indirectly determining limits for the autonomous credit expansion of the other banks. *The money supply will thus change with changes in government borrowing from the central bank, with changes in currency reserves and with changes in the lending of commercial banks and in their central bank deposits.* The central bank or fiduciary authority can also influence monetary supply and the resource allocation in the economy by imposing credit restrictions and rationing devices on the money market.

Before the establishment of a central bank in Tanzania, the Bank of England can be said to have served as fiduciary authority with its influence channelled through the corps of international banks operating in the country. With a fixed rate of exchange and with basic discount rates determined in the London market, the opportunities for independent "monetary policy" were then in fact limited to possible restrictive policies practices by the commercial bank community.

That part of the financial intermediation system which does not deal with money is called the capital market. The money market and the capital market are closely interlinked by relations both of complementarity and substitutability.

Operations in the money markets complement capital market operations by providing the necessary medium of transaction and also usually by taking care

of the first stage of intermediation between individual savers and investors. Surplus money accumulates in the commercial and savings banks' deposits and is then channelled to individual investors or lent to other capital market intermediaries to be further invested in real assets.

But money is also a substitute for capital investment from the point of view of the individual investor. Only by including money or "near-money"³ in his asset holdings can the investor make sure that his investment portfolio of assets reflects his preferences as to liquidity, yield and risk.

This interlinkage of the money and capital markets also implies that monetary policies affecting monetary supply, credit allocation and interest rates will also help to determine price, yield and availability of capital assets and thus the functioning and volume of the capital markets. By turning off the money flow the monetary authorities can e.g. effectively stop investments in specific sectors or keep new capital market instruments or agents from developing.

1.1.3 The Economic Setting of the Financial System

The opportunities and operations of a country's financial system will to a large extent reflect the general economic conditions and restrictions prevailing in the country. For understanding and interpreting the financial history of a country like Tanzania, there are four distinctions or characteristics of the national economy, which are particularly important to keep in mind.

The first distinction is that between an *open* and *closed* economy. In an open economy, with a free international exchange of commodities and capital, the possibilities of maintaining an independent monetary policy and an effective control of the national financial system are severely limited at least in the case of a small country. The level of interest rates as well as other conditions and criteria of lending tend in the long run to be determined by the alternative international sources of finance. Attempts of establishing monetary norms and interest rate levels substantially deviating from those prevailing in the international credit markets will then in general prove selfdefeating. Such attempts will only set in motion capital flows over the border which in turn will necessitate such adjustments of the rate of exchange as will tend to eliminate the deviations. The introductions in Tanzania in the middle 60s of currency controls and restrictions on international capital movements was thus a logical step for a government aiming at establishing an independent or autarchic control of monetary policies and of the pricing and use of capital assets.

The second important distinction is between a *developed* and *less developed*

³ "Near money" is defined to include time and savings deposits.

economy. The aspect of the complex notion of development which particularly concerns us here is the degree of market integration. One of the most common and striking characteristics of LDCs is the dichotomy between a modern and a traditional sector. The modern sector tends to be oriented towards international exchange and to make full use of the credit facilities of financial institutions. The traditional sector, which usually also includes a large non-monetized "subsistence economy" has often little access to these formal credit opportunities, due both to a mutual lack of information and a lack of normal securities. One obvious consequence of this dichotomy is that the financial markets of the LDCs will be fragmented in the sense that various economic agents face different rates of return for similar kinds of investments. Public credit policy will have a different impact on the modern sector than on the traditional sector, whose people appear as depositors but seldom as borrowers on the ledgers of commercial banks.⁴

A third distinction is that between economically *dependent* and *independent* economies. We have here chosen to define dependence in terms of ownership. An economy is called dependent when a dominant part of its industrial and financial capital is controlled by foreign owners who are able to exercise a certain monopoly power. Many LDCs have like Tanzania inherited a financial dependence from their colonial history. The lack of national ownership control will then further aggravate the difficulties of making effective an independent credit market policy in a less developed economy. If the economy is open, the foreign ownership can be expected to facilitate financial arbitrage and thus further narrow the permissible range of discretionary monetary policy.

The divergent interests and cultural background of the foreign owners and

⁴ Following Newlyn (1967), one may distinguish four stages in financial development from a pure barter economy to a fully developed financial system. The distinction is mainly useful for analytical purposes, as the stages usually overlap in actual experience.

The first stage in financial growth involves the introduction of commodity money in which some article with intrinsic value changes hands as a medium of exchange. In the second stage, commodity currency is handed over to an institution which issues promissory notes to the saver, and to the extent that these circulate, the purchasing power acquired by the institution becomes available for lending to investors. This stage therefore marks the origin of financial intermediation. In the third stage, the financial intermediaries realize the possibility of creating money and credit without any prior act of saving.

The intermediaries that evolve in the second and third stages are essentially monetary ones—i.e. banks. The final stage in the development of a modern financial system is characterized by the existence of a wide variety of non-monetary financial intermediaries, as well as financial instruments.

In almost all the LDCs, none of the four stages has been accomplished thoroughly. In these countries, there still remains a large non-monetized sector (sometimes referred to as subsistence sector) coexisting with a fully monetized sector. Intermediation by financial institutions in the monetized sector is still largely at the third stage, i.e. commercial banks remain the major financial institutions, accounting for about 70 % of total financial assets (Goldsmith (1969)).

operators may also make it more difficult to bridge the gap in information and incentive between the modern and the traditional sector and further delay the appearance of financial institutes and instruments especially adapted to indigenous needs.

While the first three distinctions help to describe the setting of financial markets, the fourth distinction—between *unrestricted* and *restricted* financial markets—is a way to characterize the actual outcome. A market which is both unregulated and contestible—i.e. at least potentially open to new competitors—is called unrestricted. A market can thus become restricted either by government intervention or by voluntary cartel agreements or monopolistic practices effectively impeding competition. Since we consider market restrictions to be a major factor in explaining the unsatisfactory development of Tanzania's financial markets, we will devote most of the remainder of this chapter to study the way market restrictions may affect performance in the financial markets.

1.2 Unrestricted Financial Growth in Less Developed Countries

In gaining political independence most LDSs were, like Tanzania, faced with a difficult choice of strategy in regard of the financial system. Should they place their reliance on the inherent strength and dynamic efficiency of competitive markets and hope for an “unrestricted” financial growth *or* should they instead centralize financial decisions and by government intervention shape also the financial underpinnings of the overall development strategy?

The argument for allowing competitive markets in equities, bonds and money is well-known and persuasive. Competition could in theory be expected to accomplish all the major targets of financial development in the LDSs—raising the level of saving, channelling the saving efficiently into investments with different yield and risk and, finally, overcoming the social dichotomy and creating an integrated credit market. Let us here briefly recall some major strands of the argument.

The competitiveness of the markets for equities and debt instruments, will tend to equalize returns to physical and financial assets, thereby raising the rates of return to financial savings. It will also be instrumental in aiding the appearance of new types of financial intermediaries that offer an asset menu with a broader selection in terms of scale, maturity, risk and yield. Together with the increase in rewards to saving, this will tend to raise the ratio of private domestic saving to income.

The widening and lengthening of the unrestricted financial markets will further relieve the government of the need to raise funds through inflation tax (money creation). This, in turn, may raise savings in the government sector (see Shaw (1973, p. 9)).⁵ The increase in rewards to domestic assets may also reverse the flight of domestic funds abroad, and hence increase savings from the domestic sector.

Unrestricted financial growth implies the widening and lengthening of the financial markets in which investment opportunities compete for savings. This opens the way to superior allocations of savings. Moreover, the use of prices, in form of interest rates, to discriminate between investment alternatives may be congenial to the appearance of new investing firms and innovative investment projects.

In unrestricted financial markets, interest rates correspond more accurately to the opportunities that exist for substituting investment for current consumption and to consumers' time preference. Arguably, real rates of interest will be high in such markets, and there will be a wider spread of interest rates among financial assets, indicating a higher risk premium for primary securities purchased from the traditional sector.

Buyers and sellers in all markets are given the incentive to accumulate balances of liquid assets that make it unnecessary to waste resources on the inconveniences of barter. As a result, aggregate stocks of financial assets tend to grow relative to income or in proportion to wealth.

The decline in the risks of yield, liquidity and safety in the holding of financial assets, including money, will tend to increase monetization of the traditional subsistence sector and its use of the formal financial system. The competitiveness of the system tends to even out the differential in the rates of interest between the formal and the informal (represented by money-lenders and other unorganized channels, mainly operating in the traditional sector) markets. Thus, the capital markets become more and more integrated, and this further creates improved opportunities for mobilizing and deploying savings.

The competitiveness of the financial markets and the associated widening and lengthening of the market for loanable funds pave the way for conducting monetary policy by using traditional instruments, such as open market operations. The increased monetization and the integration of the financial markets will make monetary policy more effective by widening its sphere of influence, as well as by diversifying its tools of operation.

This is in brief the text-book view of unrestricted financial growth. Quite

⁵ This is partly because inflationary financing of the government budget tends to raise government expenditure in the subsequent periods (see Aghevli and Khan (1978)).

apart from its possible value as a political prescription it can usefully serve as a benchmark or reference alternative for evaluating the financial policies actually pursued in Tanzania and elsewhere. To understand the complexity of the choice facing the LDSs one should however keep the following in mind.

Firstly, unrestricted financial growth is not automatically realized by the government doing nothing—i.e. pursuing a policy of *laissez-faire*. If the starting-point, as in Tanzania, is an open dependent economy, without a national central bank but with financial operations mainly in the hands of foreign commercial bankers, some active government policies will surely be needed to form the instruments and institutions of monetary policy and to ensure the existence of domestic competition within the financial establishment. This task of swiftly building up the institutional frame-work for competitive financial markets while at the same time abstaining from pre-empting the decisions of the market players, certainly requires a high degree of political and economic sophistication. Very little can be learnt about this from the economic text-books and neither can the history of the industrialized countries really be said to provide the models needed.

Secondly, the lack of incentives, information and experience on the part of the potential domestic entrepreneurs, may in reality make a fast spontaneous growth of financial markets difficult to achieve. The process of learning and of assimilating new values and attitudes may be very time-consuming, requiring more political patience than the voters are likely to show.

1.3 Restricted Financial Regimes

The key characteristics of unrestricted financial regimes discussed in previous sections were the existence of a structure of interest rates well adapted to the spectrum of yields and risks in yield available from investment projects in different sectors of the economy and, closely related to this, the contestability of financial markets and institutions. Conversely, where the adaptability of the interest rate structure to the investment opportunities actually available is low and financial markets are non-contestible, the financial regime may be said to be *restricted*.

Several circumstances explain the evolvment of restrictions on the financial systems of LDC:s during the post-war period. Many LDC:s retained a colonial status for more than a decade after the end of World War II and during this period their economies may be characterized as being dependent and open. There was no independent central bank or corresponding monetary authority to conduct monetary policy and the financial institutions were to a dominating

extent branches of overseas banks. Formation of cartels among the pioneering banks, coupled with laws that restricted, or made it difficult for the indigenous people to register their own banking institutions illustrate the monopoly nature of the banking system. Sometimes these restrictions were justified as means for protecting depositors, but in effect they had the pervasive effect of hampering competition in the financial sector (cf. Chapter 4).

Through the openness of the economy, it is reasonable to assume that the domestic financial market more or less had to accept the rates of interest determined by the international markets. The financial costs of investment in the modern sector (dominated by foreign enterprise) would therefore be similar to those prevailing on for example the London market for similar investments. This dependence on overseas markets did not necessarily create a problem for the development of the financial system. The dependent nature of the economy, and the way in which modern financial institutions got transplanted as branches of foreign banks meant, however, that there was a tendency to concentrate banking services on the foreign (export) enclave of the economy and neglect the traditional sectors. This tendency was reinforced by enactment of legal provisions by the colonial government to restrict credit extension by the foreign banks to the indigenous entrepreneurs (see Nsekela (1978)).

Accessibility to bank credit by the indigenous sectors was also blocked by the requirements for collaterals and reputations (with regard to borrowers) that were known to the overseas bankers.⁶ As a result bank credit was almost entirely directed to licenced foreign trade activities, highly protected industries, international corporations and various government agencies. The traditional sectors acted only as depositors.

Though discriminatory in its nature, the neglect of the traditional sectors may at least to some extent have constituted a rational behaviour on account of the dominating foreign banks. Adherence to overseas banking practices may have meant that the transaction and information costs involved in extending credit outside the modern sector were regarded as being prohibitively high and requiring unrealistically high risk premia. The *monopoly* nature of the banking system, described above should then be regarded as the key restriction on the financial development. This made difficult the formation of domestic and locally based financial institutions, which possibly would have been more effective in the search for profitable investment opportunities within the domestic economy (especially in the traditional sector). The openness of the economy may furthermore have reinforced the tendency of the modern banking system to neglect the traditional sector. There was no need to accept the squeeze of

⁶ See Eshag and Kamal (1967).

profit margins likely to be involved in the high cost activity of extending credit outside the modern sector, since the free access to international markets rather meant unlimited opportunities for maintaining profitability.

The end of the colonial era did by no means automatically bring about an end to restrictions on the financial system. In many LDC:s, the dawn of independence meant that restrictions originating from the dependent and open status of the economy were gradually replaced by restrictions brought about by domestically engineered *regulations*. This implies in the end a rather drastic change of financial regime. Although still "restricted" in the sense defined above, the substitution of regulated prices for free market prices marked a decisive shift in the whole economic system. It really meant that one tried to remedy the shortcomings of market competition under the bank cartel by abolishing competition altogether.

Regulations of various markets—and the financial market in particular—were often prompted by the belief that markets function badly (McKinnon 1973). To rectify this and to promote rapid growth, governments of many countries opted for a development strategy that entailed intervention with the markets for land, labour, capital and produced commodities. Thus, regulation of financial markets is only a part of a wider development policy package. Other possible reasons for the choice of an interventionist type of development strategy include a colonial heritage of a relatively strong government apparatus and a relatively weak base of indigenous entrepreneurship. The 'strong' government apparatus is trusted to have the capacity of regulating the growth of the economy, while the costs of development in the context of the 'weak' markets are considered unacceptably high.

One must also bear in mind the influence of a strong civil service, eager to strengthen its class position and benefits from corruption that arises from the allocation of import licences, credit and investment permits, allocations of cheap supplies from government enterprises and so on.

Failure to appreciate the role played by markets in the allocation of resources, and to recognize the costs involved in rationing provide additional explanation for the adherence to regulations.

Competition in the financial markets has been ruled out by the creation of state monopolies in the financial sector, mainly through nationalization of private financial institutions. The main motives toward such nationalizations have been two-fold: the argument that the private—mainly foreign—institutions operating in the sphere were exploiting the nation, and the desire to distribute more effectively the mobilizable financial resources in favour of the public (state-owned) sector.

The other main manifestation of restrictions on the financial system was the replacement of market pricing as a means of allocating financial resources by quantity rationing and regulations of the range of interest rates. The blame for

interest rate regulation may partly be attributed to what Phelps Brown (1972) calls 'the underdevelopment of economics'. In particular, numerous models of economic growth that have guided policy in the LDCs in the post-war period, have implicitly tended to justify the regulation of interest rates. These include the models based on incautious interpretation of Keynes' saving-investment function (cited above), as well as the so-called models of structural inflation.⁷

For a simple version of a Keynesian fixed-price model, for example, it appears that the expansion of nominal money may *eliminate capital scarcity* by reducing the marginal liquidity yield of real money balances and the rate of interest. To the extent that money demand is interest elastic, the reduced interest rate will induce increased output and investment, as well as a fall in the marginal product of capital and a rise in the wage rate. In the models of structural inflation, the price level is assumed to be rigid downwards, but subject to increase under pressure of non-monetary factors in the markets, especially those of agricultural produce (mainly foods) and of foreign exchange, which because of their *structure*, tend to produce price increases independent of excessive monetary expansion. Increases in the price level generate excess demand for money, resulting in higher rate of interest, reduced investment and income, unless counteracted by equiproportionate increase in nominal money. If interest rates do not respond to changes in money supply, as some structuralists would argue, then they must be regulated.

Thus, interest rate ceilings are a solution provided by the structuralists, so long as the expected inflation is higher than the realized one, or where one believes that lenders are exploiting borrowers in an unstable market.⁸

A common characteristic of both the neo-Keynesian and structuralist models such as those discussed above, is the implicit assumption that money is part of wealth, i.e. compete with other financial assets in the wealth portfolio of economic agents. Thus, the models emphasize that the growth in money supply is accommodated at the expense of capital accumulation. However, as argued by McKinnon (1973), in the developing countries, with fragmented capital markets, money is essentially a conduit for capital accumulation.

Another criticism against the models described above is that they neglect the importance of compensating for the fact that high inflation rates tend to reduce the demand for money, leading to an increase in the rates of interest, and hence a fall in investment. The models provide a rationalization of inflation as inevitable and necessary for counteracting the substitution effect of growth in real money balances on capital accumulation, and suggest policies—such as interest rate ceilings—which intensify capital scarcity.

In short the structuralists ignore the market for money, and fail to allow for the role played by the demand function for money in the inflation process. Whether, for example, money wage-rates, or agricultural prices are leaders in the inflation spiral, the ultimate source of the spiral should not be traced in the 'fault structure' of one or another sector, but rather in excess money supply.

The apparent unwillingness of governments in many LDC:s of adjusting nominal interest rates to changes in the rate of inflation is often seen as an at-

⁷ For a thorough review of these models, see for example Thirwall (1974), ch. 3.

⁸ For a detailed discussion of this point, see Shaw (1973), p. 101.

tempt to keep the costs of financing the public sector deficits as low as possible. Such temptation is likely to be stronger when the public sector financing requirements are expected to be high. A related explanation is the belief that low interest rates, especially on deposits, would help to strengthen the financial institutions by protecting their earnings. The policy of restricting the range of variation of interest rates, furthermore, may also be viewed as complementary to usury laws, limiting interest on moral grounds.

1.4 Some Consequences of Restrictions

Restrictions on the formation, as well as the lending and borrowing activities of financial institutions directly impinge on financial widening. Moreover, where non-contestability has been a result of cartel formation by a group of foreign banks, or establishment of a state monopoly by nationalization, widening of the financial system to some sectors or some geographical areas may be severely limited.

In reality, however, limitations on widening almost necessarily imply obstacles to lengthening of the financial sector, and thus its limited growth. Nevertheless, lengthening is also hampered by the low real rates of interest, which discourage the demand for financial assets, thereby reversing the economy toward self-finance.

By hampering the development of specialized financial institutions and instruments, formal finance remains dominated by deposit banks and finance from foreign sources (external grants of aid, high-cost suppliers' credit and direct foreign investment). In this connection, few financial assets, mostly money and bank deposits, become available. The limited availability of a diversified financial asset menu narrows the range of savers' portfolio choice, and this—together with the ceilings on interest rates—tends to discourage the supply of loanable funds.

If restrictions take the form of replacing the markets by administrative controls, including credit rationing this wipes out the foundations upon which open markets for bonds and equities could evolve.

The decline in savings through the formal financial system makes it difficult for the government to finance any of its deficits by borrowing from the system. Consequently, for financing its deficits the government resorts to money creation. Thus, there may arise a close connection between public deficits, bank lending and inflation.

In the regime of undeveloped regulated financial system, the meagre savings that flow from households and firms—probably due to absence of alternative

saving channels—are most rationed to firms. As a result, any credit squeeze will tend to affect aggregate supply, rather than demand.

As an implication for the conduct of monetary policy under the regime in discussion, it should be mentioned that the possibility of applying the traditional tool of open market operations, becomes severely limited due to the absence of a functioning capital market.

Following Aghevli and Khan (1978), and Coats and Khatkhate (1978), it may be argued that inability of the monetary authorities to conduct contractionary monetary policy will tend to create a sort of a vicious circle of inflation and regulations. Thus, an inflation spiral originated by an increase in government borrowing from the banking system depresses the demand for financial assets due to the fixity of nominal interest rates. The increase in government borrowing will at the same time entail domestic supply compression, attributable to the displacement of private activity by government activity (crowding-out). The latter in turn implies a deterioration in the government's revenue base in the subsequent period, and this, together with the decline in savings (due to low real rates of interest) will lead to increased inflationary financing of the budget. On the other hand, increased excess demands resulting from the monetary expansion will at the same time give rise to more controls/rationing.

The first obvious effect of credit rationing in the formal markets, and of discriminating against the traditional sector, is increased recourse to informal finance.⁹ The attendant increase in dichotomy renders the conduct of monetary policy more unattainable. The second effect, which arises when rationing of credit is made in favour of the public sector, is the so-called crowding-out.

Generally, the crowding-out effect¹⁰ may be discussed in two interrelated contexts. First, the public sector purchases large quantities of goods and services and finances these purchases either by taxes or borrowing. To the extent that these purchases are used in the public sector, they will no longer be available as inputs to production in the private sector. As a result, the output of the private sector is forced to decline, *ceteris paribus*. This is referred to as 'direct' crowding-out. In the second context, usually called 'financial' crowding-out, the government's increased borrowing drives up the interest rate, thereby making the access to credit by the private sector more expensive. Consequently, the private sector is also forced to curtail the part of its capital needs that is not self-financed.

In the case with interest rate ceilings, only the 'direct' crowding-out would

⁹ For more discussion of this issue, see, for example, U Tun Wai (1957).

¹⁰ For a more comprehensive discussion of this issue, see, among others, the review articles by Blinder and Solow (1975), Friedman M. (1970), Buiter (1977). See also Tobin and Buiter (1976).

seem relevant, as ceilings rule out the possibility for 'financial' crowding-out in the sense described above. 'Financial' crowding-out takes the form of capital rationing.

In the long-run, the crowding out effect should be expected to be relatively more severe in the case with financial regulation. This is because, in the absence of interest rate regulations, the rise in interest rates induced by increased public sector borrowing does not affect the private sector's demand for credit, but also induces an increase in the overall level of savings. With time, the latter will tend to dampen the crowding-out effect by inducing financial deepening (Tobin and Buiter (1976)). On the contrary, where financial regulations exists, with the result that 'direct' crowding-out does not drive interest rates up, savings mobilization is hampered, and recourse to self- and informal finances accentuated.

1.5 The Effects of Restrictions in the Tanzania Financial System—A Working Hypothesis

My basic hypothesis is that the Tanzania's financial experience during 1950—80 may be divided into two sub-periods: 1950—65 and 1966—80. The first of these sub-periods, 1950—65, may broadly be characterized to have involved restrictions by monopoly in an open and dependent economy. The period 1966—80 is seen as one in which financial restrictions were fulfilled by regulations in a closed economy. The characteristics of the types of restrictions in the two sub-periods will have implications on financial growth. These implications will be traced in the following chapters of the book.

a) Restrictions in an open and dependent economy—1950—65

During the period 1950—65, the economy of Tanzania might be characterized as being *open* in the sense that restrictions on foreign trade and capital movements were absent. The country had no independent central bank (or other monetary authority) to effect financial policy. The issuing authority—the East African Currency Board (EACB)—ensured automatic convertibility of the domestic currency into British (sterling) pounds. As a result, the domestic financial market, which was dominated by branches of multinational commercial banks, became closely tied to the London market.

The monetary openness of the economy had two main implications. First, the interest rates were taken from the London market. At least as far as the operations of the financial system with the modern sector (dominated by foreign enterprise) was concerned, it was impossible to charge rates of interest (ex-

cluding risk premium) that differed from those prevailing in the London market, as this would have implied increased capital flows to equalize the rates. The second implication, connected with the first, is that the foreign owned financial institutions were not compelled to search for investment opportunities within the domestic economy (especially in the traditional sector). This is because they could always invest the funds they mobilized in 'first class' (low risk) securities offered by the international financial markets.¹¹

In the period under review some legal provisions were in operation that had a direct bearing on the financial markets. Important among those were The Credit to Natives Restriction Act of 1931 and the Banking Ordinance of 1960. The 1931 Act stipulated that the indigenous folk must go through a complicated bureaucratic procedure and receive permission from their local (mainly expatriate) government officials before they could approach banks for credit, while the 1960 Banking Ordinance set out requirements for the formation and registration of financial institutions that were almost unattainable by the indigenous population.¹²

As far as financial growth is concerned, one may tentatively conclude that the economic regime prevailing during 1950—65 could have induced some financial widening and lengthening due to general expansion of the modern (relative to the traditional) sector and the competitiveness of the financial market vis à vis the international financial market. However, the extent of such growth was limited by the discriminatory nature of the system against the indigenous sectors, which supplied the major part of the total savings.

b) Restrictions in a closed and independent economy—1966—80

The way in which the economy, and the financial system, was restricted during 1966—80 differs from that of the preceding period in several respects. First, during 1966—80 the economy was closed by the introduction of foreign exchange controls in 1965. Second, the closure of the economy paved the way for the conduct of monetary policy, for which purpose a national central bank (the Bank of Tanzania) was created to start operations in 1966. Third, the government adopted, in 1967, a socialist oriented strategy of development entailing a policy for rapid expansion of the public sector (at the expense of the private one) by direct rationing of resources in favour of that sector. This policy had the effect of denigrating the role of the market. Fourth, to effect this policy, in the sphere of finance, the financial system—including the commercial banks and the insurance companies—were nationalized in 1967.

¹¹ The export of capital from an open LDC to the developed economies may be explained by recourse to this argument. The case of Tanzania is discussed in Chapter 4.

¹² The Credit to Natives Restriction Act was effective up to the time of independence, but one may still say that it left a 'hang-over'.

Within the framework of the foregoing scenario, the government regulated the financial system by the use of nominal interest rate ceilings, and central financial planning (which simply meant credit rationing in the light of excess credit demand due to fixed low interest rates).

The desire to rapidly expand the public sector increased the government budget deficit. Due to nominally fixed rates of return to financial assets and non-contestability of the financial market, private saving within the financial institutions was low, and the government failed to finance its deficit by borrowing outside the Central Bank. The government was therefore forced into the printing press for money to finance its deficit. The latter was associated with inflation, which further eroded the fixed nominal interest rates producing low positive, or even negative, real interest rates. This reduction in real rates of interest continued to drive economic actors away from the formal financial sector, probably to the informal sector.

It is reasonable to assume that the rationing of loanable funds in favour of public enterprises and well established private firms reinforces tendencies towards self-finance, with its negative repercussions on investment allocation.

The excess demands created by the government's inflationary financing and price controls spilt over into the capital account of the balance of payments, forcing the country to draw on high-cost, short-term credits.

In view of the arguments presented above, it might be postulated that during 1966—80 the widening and lengthening of the financial sector was hampered by direct government regulation. One would, therefore, expect the total of financial assets (by value) to have grown little relative to income or national wealth.

Chapter Two

The Setting

2.1 A Short Historical Note

The history of modern economic development of Tanzania Mainland (formerly known as Tanganyika) may be dated back to the German colonization in 1884. The German rule more or less ended by the outbreak of the World War I, as by 1916 the British troops had won the battle against the Germans in Tanzania Mainland.

After the end of the World War I, the League of Nations gave its mandate to Britain (which was already ruling in Kenya and Uganda back from 1884) to administer the territory. The political status of Tanzania Mainland remained so unclarified until after the World War II (in 1946), when it was declared a United Nations Trust Territory under British administration.

Political independence from Britain was achieved on 9 December 1961, and union with Zanzibar—to form the United Republic of Tanzania—reached immediately after the victory of Zanzibar's revolution, which overthrew the Sultani-rule in 1964.

Under the British rule, in 1948, a common services organization called the East African High Commission (EAHC)—reorganized into what was called the East African Common Services Organization (EACSO) in 1961—was formed with the purpose of providing the main public utilities on an East African basis (Kenya, Uganda and Tanzania Mainland).¹ In 1967, the EACSO was reconstituted as the East African Community. The latter broke up in 1977, mainly due to political tensions in the area and great dissatisfaction on the distribution of the benefits of economic integration among the member countries.²

Two historical events that took place during the post-independence period are worth mentioning here: the first was the adoption of the Arusha Declaration in 1967. This declaration set Tanzania on a socialist orientation.³ The second

¹ The public utilities that were offered on an East African basis included air, railway and marine transport, posts and telecommunications, university education, and environmental research.

² It was felt that most of the gains were in favour of Kenya—the most industrially developed among the members. For more discussion of this issue, see, for example, Hazlewood (1975).

³ For a politico-economic discussion of the Arusha Declaration, see, for example, Mwansasu and Pratt (1979).

event was the outbreak of war between Tanzania and Uganda (called the Idi Amin war) in 1979. The war culminated with Tanzania's victory and replacement of the Idi Amin rule in Uganda by a liberation front that fought side by side with Tanzanian troops.

2.2 Some Aspects of Economic Development During 1950—80

2.2.1 The Prelude to 1950s

The thirty years of German colonial rule in Tanzania were concentrated on the development of cash/export crop production in european settler estates (plantations), as well as on the building-up of the transport infrastructure for the 'export enclave'.⁴ Thus, by the eve of the World War I, the Germans had introduced and developed the production of coffee, cotton, sisal, tea and tobacco, and opened two main railway lines—the northern and the central lines.

Nevertheless, the Germans discouraged export crop production by the indigenous people, but encouraged them to supply their labour to the plantations in order to earn the cash for hut-and poll-tax payments. As a result, the spread of the modern economy (monetary sector) into the traditional economy became limited.

During the period 1919—45, the political status of the country remained unclarified, and the British colonial government took no serious measures for promoting economic development. Only after the clarification of the country's political status in 1946, did Tanzania embark on a phase of rapid economic growth and structural change.⁵

2.2.2 Economic Policy Making During the Post-War Period

By the criterion of the tools used for achieving economic policy targets, one may distinguish two sub-periods in Tanzania's economic history during 1950—80. In the first sub-period, 1950—65, economic policy was mainly concerned with maximization of growth through private enterprise, coupled with strict adherence to external and internal balance. The second sub-period, 1966—80, was mainly associated with the adoption of the Arusha Declarations,

⁴ See, Illife (1979).

⁵ See, IBRD Mission Report (1961).

and may be characterized as one in which economic policy simultaneously aimed at growth maximization and redistribution of income through public sector enlargement (Green (1979)).

The major policy goals during 1950—66 are well characterized by the recommendations of the World Bank mission to the government in 1961. These recommendations were later embodied in a Three-Year-Plan for 1961—63, and partly in the First-Five-Year-Plan (FFYP) for 1964—69. The major policy objectives formulated in the two documents—the Three-Year Plan and the FFYP—were three fold:

- a) promoting rapid growth through increased agricultural output, based on improvement of productivity of the existing traditional methods, coupled with gradual transformation into more capital intensive agriculture;
- b) developing the socio-economic infrastructure;
- c) achieving structural change by promoting import-substituting industries.

Policy instruments during 1961—65

During 1961—65, the policy targets were mainly attained through measures of fiscal type. Thus, for example, tax-efforts (as those discussed by Kaldor (1963)) were applied to ensure the growth of recurrent revenues by an average of some 15—16 % annually during 1961—66 (far ahead of the real GDP growth rate of about 5.9 % during that period when inflation rate was of the order of 2—2.5 % per annum). At the same time recurrent spending was restricted so as to realize savings for the finance of the government's capital budget.

Other fiscal measures that were used include the enactment of the Foreign Investment Protection Act (Tanganyika Act No. 40) of 1963, aimed at mobilizing external resources for investment. In particular, sections 6 and 7 of that Act provided for guarantees for fair compensation for nationalization, and for repatriation of profits after tax and of principal and interest charges of loans taken by foreign enterprise. Moreover, in order to encourage the cooperation of the private sector in the development effort, the government created i.a. the following market incentives:

1. Provision of adequately equipped industrial sites, and protection (plus assistance) of infant industries by appropriate external tariffs and accelerated depreciation, as well as other investment allowances;
2. Provision of economic surveys and feasibility studies of all the country's industrial potential to likely investors (organized along the lines sketched by the Arthur D. Little survey team of 1961);⁶
3. Government participation in financing enterprises through the intermediation of the government owned Development Corporation, formed in 1962.

⁶ See, Arthur D. Little (1961).

Economic policy making during 1966—80

During 1966—80, economic policy was mainly formulated along the guidelines of the 1967's Arusha Declaration. Following Green (1979, 1982), the policy may be summarized under four main headlines: overcoming absolute poverty and redistribution; economic restructuring; mass participation and public sector leadership; growth and balance.⁷

Broadly speaking, the implementation of economic policy during 1966—80 relied mainly on administrative controls in the labour, financial and commodities markets. Below, I list some of the controls in each of the markets, which might have had a direct bearing on financial policy.

The *labour market* has been controlled in three main ways: by imposing wage and salary regulations, by securing full control over the workers union, by direct government regulation of rural-urban migration.

The most important controls pertaining to the *goods market* include: control of agricultural producer prices and of consumer prices. The regulation of consumer prices was pursued on ad-hoc basis from 1967 up to 1973 when it was systematized with the formation of the National Price Commission (NPC).⁸ Import licensing was introduced in 1970/71 following a minor balance of payments crisis.⁹ Direct rationing has been used for the distribution of basic commodities especially in the periods of acute scarcity that have been common from 1974/1975.

Behaviour in the *financial markets* was less directly controlled up to 1971/72 when financial planning on an annual basis was introduced. The introduction of annual finance and credit plans—including the Government Revenue and Expenditure Plan (covering the recurrent and the development/capital budgets), and the Money Supply and Credit Plan; annual foreign exchange plan and the annual development plan in 1971/72—reflects the financial resource constraints that emerged towards the end of 1960s (Green, et al. (1980, pp. 6—12), Rwegasira (1976)).¹⁰

⁷ For a detailed discussion of these policies, see Green (1979, 1982) and Green et al. (1980).

⁸ Producer prices for most agricultural commodities, retail prices for basic foods and charges for public utilities are excluded from the purview of the NPC. Moreover, there are still a large number of consumer goods whose prices are not controlled—especially imported and domestically produced in intermediate and capital inputs. For the method of price control used cf. Robert Rice (1976).

⁹ The creation of the import licensing scheme in Tanzania is assessed in chapter 5.

¹⁰ The technique and performance of financial planning in Tanzania are more thoroughly discussed in Chapter 5. See also Nyirabu (1978) for a discussion of the planning procedure.

2.2.3 Structure of the Economy

The dominant economic activity of Tanzania has been agriculture, employing over 85 % of the total population in 1980. Although the share of agriculture in the gross domestic product (GDP) of the country declined gradually since 1950, in 1980 it still maintained a share of about 40 % (see Table 2.1).

As seen in Table 2.1, the fall in the share of agriculture in GDP during 1950—80 occurred simultaneously with a rapid growth of the tertiary/service sectors. Their contribution to GDP rose from about 25 % in 1950—54 to 46 % in 1976—80. During the same period, the contribution of the secondary sectors (industry) to GDP rose only slightly from about 10 % to 14 %.

Monetization of the traditional economy

During the period 1950—80, the economy got rapidly monetized, mainly as a result of increased participation by the indigenous population in cash/export crop production. The government tried to encourage—through the cooperative movement that was initiated back in 1932—the indigenous population to undertake cash/export crop production, which in the 1950s had the following effects:

- a) rapid increase in the number of agricultural marketing cooperatives registered by the African population, rising from 120 in 1950 to 700 in 1960;
- b) a considerable increase in the contribution of the indigenous people to the recorded rise in the value of the main export crops.¹¹ Thus, whereas in 1945, the total produce of sisal, papain, tea, pyrethrum, wheat and about 75 % of the exports of tobacco, were estate produced by a minority of settlers, in 1960, only one crop—tea—was entirely estate produced (see Fuggles-Couchman (1964, p. 45)). Moreover, four of the crops—cotton, cashewnuts, castor seeds and sesame—were entirely produced by the indigenous folk;
- c) rapid expansion of the market economy (commercialization), exemplified by the growth of the marketed quantities of food crops. As seen in Table 2.2, the sales of cassava rose almost five-fold during each of the sub-periods 1945—52 and 1952—60, while those of maize and rice more or less doubled in each of the corresponding periods. On the aggregate, to use a rather crude measure, the overall tonnage of marketed foods rose almost six times—from about 37 000 tons in 1945 to 200 000 tons in 1960.

In line with the rapid monetization, the share of the subsistence sector in the total GDP declined from about 47 % in 1950—54 to 34 % in 1961—65. The downward trend of the subsistence sector share in the GDP continued up to

¹¹ The value of the main commodity exports rose almost seven-fold during 1945—60 (see, Erlich (1964)).

Table 2.1. Tanzania: Economic Structure, 1950—80

SECTORS	percentage shares in GDP at 1966 prices				
	1950-54	1961-65	1966-69	1971-75	1976-80
I: Agriculture	64.8	53.9	43.3	38.7	40.3
Industry (incl. mining, processing, construction, public utilities)	10.3	11.5	16.2	17.0	14.2
Services (incl. commerce, transport, finance, public administration)	24.9	34.6	40.5	44.3	45.5
TOTAL GDP	100.0	100.0	100.0	100.0	100.0
II. Of which: ¹²					
Monetary	53.5	66.2	69.1	71.1	63.0
Subsistence	46.5	33.8	30.9	28.9	37.0

Sources: For the period 1950—54, see Ord (1962). For the rest of the period, see Tanzania: Statistical Abstract (various) and National Accounts (various).

Table 2.2. Sales of major food crops (Selected years, 1945—60) (Quantities in tons)

CROP	1945	1952	1960
Cassava	2,669	10,809	55,252
Maize	20,450	42,310	77,946
Rice (Paddy)	8,739	15,639	34,859
Pulses	4,480	20,751	24,443
Seed Beans	490	1,651	5,620
TOTAL	36,828	91,166	198,120

Source: Tanganyika: Department of Agriculture, Annual Reports, 1945—60.

1971—75, when it had reached about 29 %. However, in the period after 1975, the share of the subsistence sector in GDP reversed to an upward trend, recording an average of 37 % during 1976—80. The increase of the subsistence, relative to monetary, activities during the latter periods is mainly explained by two factors:

- i) acute scarcity of essential commodities during the period, especially after 1978, due to severe restriction of imports following the deterioration of the balance of payments and the foreign reserve posi-

¹² Subsistence is defined as that part of GDP, which is directly produced and used by its producers without being exchanged for money. That part of GDP, which is exchanged for money is termed monetary GDP.

tion accompanying the second oil price increase of 1979 (see also the following section on balance of payments);¹³

- ii) related with the (i), relatively higher inflation rates during the period (see forthcoming section on the inflationary experience).¹⁴

2.2.4 Growth Performance

The real growth rate estimates for Tanzania's GDP during 1954—81 are summarized in Table 2.3.

As seen in Table 2.3, the economy performed relatively well up to the mid 70's with the average annual growth rate well above 5 %. A comparatively high rate of growth was sparked in the 1950s and, contributing to this was the introduction of government development planning and the groundnut scheme in 1946, as well as the encouragement of the indigenous folk to undertake cash/export crop production.¹⁵

Of particular concern is the dramatic fall in the GDP growth rate to an average of 2.6 % during 1978—81—implying negative income per capita growth in the light of the population growth rate of 3.3 % per annum. The major reasons for the deterioration in Tanzania's GDP growth in the second half of 1970s are:

- a) the oil price increases during 1974—75 and 1979, coupled with stagna-

Table 2.3. TANZANIA: Estimates of Real GDP Growth Rates, 1954—81 (Averages for selected years, in percentages)

	1954-60*	1961-65*	1966-69	1970-73	1974-77	1978-81
GDP at 1966 prices	6.8	5.8	6.0	5.0	5.3	2.6
of which						
Monetary GDP	8.0	2.2	7.2	5.5	4.8	2.9
Subsistence GDP	4.6	11.7	3.5	3.5	6.8	3.1

Note: * The current 1954—64 figures were deflated to 1966 prices by using the Retail Price Index.

Sources: 1) Tanzania: Statistical Abstract, various issues. 2) Tanzania; National Accounts, various issues.

¹³ The scarcity created an active black market for almost all goods (see Green (1980)).

¹⁴ For a discussion of the relationship between inflation and monetization, see, for example, Chandavarkar (1977).

¹⁵ The groundnut scheme was a capital intensive project for the production of groundnuts in the southern regions of Tanzania. The project was worth EAS 400 million (more than 3-times the average annual current revenue of the government during 1946—50). Although the scheme was abandoned in 1950, it left behind a large stock of physical and human capital that was used in the various sectors (for more details, see Frankel (1953)).

- tion/fall in the prices of the country's export commodities—both implying a deterioration in the country's terms of trade. This terms of trade decline, together with declines (or stagnation in a few cases) in production volumes of the major export crops—attributable to droughts and improper government producer price policies (see Green et al. (1980))—lowered the country's capacity to import, among other things, intermediate inputs for industries;
- b) the break-up of the East African Community in 1977, necessitated the use of a large part of investment in building the infrastructure for providing on national basis the economic services that were provided on East African basis;
- c) the war with Uganda.

In order to understand better the problems that faced Tanzania during the 1970s, and especially after 1978, a survey of trends in the country's balance of payments is necessary.

2.2.5 Tanzania's Balance of Payments Performance

During the colonial period, only the merchandise trade balance data was published. Complete balance of payments data for Tanzania is available only from 1961 (see Annex 2.1).

In the five year period that followed independence, the economy continued to be open—in the sense of having both high ratios of external trade to monetary GDP (averaging 43 % and 42 % for exports and imports respectively) and non-restrictive foreign exchange policies (see Table 2.4). However, in 1965, the

Table 2.4. Tanzania: Ratios of Trade to Monetary GDP. (Average Annual percentages)

	1961-65	1966-69	1970-73	1974-77	1978-81
Ratios to Monetary GDP of:					
Exports	43.0	36.8	32.5	26.9	27.8
Imports	42.0	35.7	41.2	43.9	50.6
Total Trade	85.0	72.5	73.7	70.8	78.4
Current Account Balance	2.1	0.3	-7.9	-9.9	-18.5
Capital Account Balance	1.2	1.6	10.3	8.7	11.0
Overall Balance* (= Change in reserves)	0.1	-1.6	-1.4	0.5	3.9

* A minus (—) indicating increase in reserves. The number for the current and capital account balances do not add to the figure given for the overall balance because of errors and omissions in the data. See Annex 2.1.

Source: Bank of Tanzania (adapted from).

government introduced foreign exchange control as a step towards restricting the economic openness.

During much of the 1960s, the trade balance was in surplus and, despite a considerable degree of capital flight in the first half of the decade, the overall balance of payments also recorded surpluses (see Annex 2.1). However, as the 1970s came on, the trade balance turned into deficits, which became particularly large in 1974—75 and 1978—80 (representing about 40—50 % of total imports in both periods). Generally, however, capital inflows were higher than in 1960s, with the result that in the specific years when export performance was good (i.e. 1972—73 and 1976—77), the overall balance recorded surplus.

As seen in Table 2.4 and Annex 2.1, the main trend in the country's trade balance during 1970s was the low growth rate of exports relative to imports. Thus, while the ratio of exports to monetary GDP declined from about 43 % in 1961—65 to 28 % in 1978—81, that of imports rose from 42 % to 51 %. This trend was partly due to deterioration of Tanzania's terms of trade mainly associated with the oil price increases, and partly due to droughts and producer price policies, which led to stagnation (or at worst—decline) in export production volumes.

Export performance

Primary commodities constituted over 80 % of total export earnings of Tanzania during 1961—81, and agricultural commodities taken alone accounted for about 70 % of total exports (see Table 2.5). The main agricultural export commodities—coffee, cotton, tea, sisal, cashewnuts, tobacco and cloves—contributed over 60 % of the total export value during 1961—81. This suggests one reason why the export performance of Tanzania may be explained by reference to weather movements. However, this factor alone is inadequate to explain the general and persistent decline in production of most of the export crops (see Annex 2.2).

It is evident from Annex 2.2 that among the three major export crops—coffee, cotton and sisal—only coffee recorded an increase in production during 1970—81.¹⁶ Output of sisal declined by more than 50 %, while that of cotton fell by some 20—30 %. Part of the crop output decline should be attributed to the persistent fall (especially in real terms) of the world market commodity prices during 1960—80.¹⁷

¹⁶ The three crops account for over two-thirds of the total value of major crop exports.

¹⁷ See Bank of Tanzania: Economic and Operations Report, various issues (section on Production and Prices).

Table 2.5. Tanzania: Percentage Composition of Exports
(Annual Averages)

	1961-65	1966-69	1970-73	1974-77	1978-81
1. TOTAL PRIMARY EXPORTS	94.0	86.7	80.6	87.7	84.9
of which:					
1.1 Major Crops*	66.3	60.6	59.1	71.9	65.1
1.2 Minor Crops**	14.5	13.6	12.6	10.6	13.2
1.3 Minerals	13.2	12.5	8.9	5.2	6.6
2. MANUFACTURES	6.0	13.3	19.4	12.3	15.1
TOTAL EXPORTS	100.0	100.0	100.0	100.0	100.0

Notes: * include coffee, cotton, tea, sisal, chasenuts, tobacco, and cloves.

** includes various cereals, animal feed, meat, sugar, oilseeds, hides and skins.

Source: Bank of Tanzania (adapted from).

2.2.6 Aggregate Investment and Saving Activities

Planned capital formation by the public sector has played an important role in Tanzania's development in the post-war period. Prior to independence, two plans were implemented. The first was a ten-year plan (1947—56), which was initiated immediately when the country became a trust territory of the United Nations. The second plan was adopted in 1955 for the period 1955—60. Both plans placed emphasis on irrigation, social services and urban amenities.

In the post-independence period, up to 1981, four development plans have been implemented: the Three-Year Plan (1961—63), the First Five-Year Plan, FFYP, (1964—69), the Second Five-Year Plan (1970—74), and the Third Five-Year Plan (1976—81). All these plans were gravely under-implemented, mainly due to shortage of finance.¹⁸

The ratios of gross and net investment to GDP in Tanzania are given in Table 2.6.

As seen from Table 2.6, both gross and net investment rates increased tremendously during the period after the adoption of the FFYP in 1964. In particular, aggregate net investment in the monetized sector as a percent of the GDP of that sector increased from about 7 % in 1964—65 to 28 % in 1978—80.

In order to assess the pressure that the high rate of investment could have imposed on domestic and external sources of financing, Table 2.7 presents the trends in the ratio of savings to GDP of the monetary sector.

¹⁸ Exception was the FFYP, which was underfulfilled mainly due to low capacity to plan and implement plan projects (see, for examples, Green et al. (1980) for more discussion of this).

Table 2.6. The Ratios of Gross and Net Investment in the Monetary Economy to Monetary GDP (Annual percentage averages).

	1964-65	1966-69	1970-73	1974-77	1978-81
Ratios to Monetary GDP of:					
1. Gross Investment	16.5	21.9	32.9	31.5	37.8
2. Net Investment*	7.0	10.3	18.8	20.7	27.5

Note: * The estimated depreciation given in the National Accounts was wholly assumed to be due to the monetary sector.

Source: Tanzania: National Accounts, various issues.

Table 2.7. Savings to GDP and to Capital Formation of the Monetary Sector (with their Private and Public Sector Components) (Annual Averages, in Percent)

	1964-65	1966-69	1970-73	1974-77	1978-81
<i>As % of Monetary GDP:</i>					
I. Monetary Savings of					
a) Private Sector	6.6	5.7	7.0	8.6	6.4
b) Public Sector	1.6	3.0	2.9	1.3	1.8
TOTAL	8.2	8.7	9.9	9.9	8.2
II. Net Investment of*					
a) Private Sector	4.7	4.7	2.9	7.3	12.9
b) Public Sector	2.3	5.6	15.9	13.4	14.6
TOTAL	7.0	10.3	18.8	20.7	27.5
III. Net Lending of					
a) Private Sector	1.9	1.0	4.1	1.3	-6.5
b) Public Sector	-0.7	-2.6	-13.0	-12.1	-12.8
TOTAL	1.2	-1.6	-8.9	-10.8	-19.3

Notes: * Net investment figures were arrived at by assuming equal shares of the private and public sectors in the recorded aggregate depreciation allowances. Because of errors and omissions in available data, total net lending as indicated here does not exactly match the current account balance of table 2.4.

Source: Adapted from Tanzania: National Accounts.

Concluding Observations

From the foregoing discussion, four main characteristics of Tanzania's economy during the post-war period up to about 1980 that might seem of general interest for the following chapters should be emphasized. Firstly, prior to 1966, regulation of the economy by the government was relatively mild, and did not involve any direct systematic controls in the various markets. After 1965, however, government regulation of the economy intensified, leading to rationing in almost all the markets. The intensification of regulations was intended to safeguard the rapid growth of the public sector, and allocate resources in its favour.

Secondly, the economy got rapidly monetized during the period up to around mid-1970s, but there was later a sharp reversal towards an increase of the subsistence sector. The rapid monetization of the economy was accompanied by relatively high rates of real GDP growth, especially in the 1950s and 1960s, when real GDP grew well above 5 % per annum. The second half of the 1970s was characterized by low rates of GDP growth (slightly less than 3 % during 1978—81).

The third major conclusion to be emphasized here is that despite the decline in economic growth during the second half of 1970s, the rate of investment (both gross and net investment to GDP ratios) in Tanzania was comparatively high—reaching up to about 28 % in 1978—81. However, it should be noted that the high investment rates were mainly due to the public sector, which was at the same time in deficit throughout 1964—81.

Fourth, it should be observed that the economy experienced an internal and external disequilibria during much of the 1970s—manifested in high rates of inflation and balance of payments deficits—and these problems became critical after 1977.

The main facts of the Tanzania's economic development during 1950—80 summed up here, have had a direct bearing on the financial development of the country. This will be traced in the following chapters.

Part Two: The Evidence

Chapter Three: The Transition to Central Banking in Tanzania

Introductory Remarks

In the following two chapters, I present a brief survey of Tanzania's financial experience up to 1966, i.e. prior to the formation of a national central bank (1966) and the nationalization of the financial system following the Arusha Declaration of 1967. In chapter 1, this period was characterized as one that involved restrictions in an open and dependent economy.

The main objective in these chapters is to show that during 1950—65, the development of financial intermediation was limited to widening and lengthening, without much deepening (growth of the total volume of financial assets relative to Gross Domestic Product). This is partly attributed to the openness of the economy, which meant that the operations of the financial system were tied to the London financial market rather than to the needs of the economy. Other factors that might have hampered financial deepening were the legal regulations which restricted the accessibility to credit by the indigenous folk, and the cartel formation by the foreign pioneering banks ('The Big Three'). The latter deterred competition in the financial sector.

The most significant financial institution in that period was the East African Currency Board (EACB), to which the whole of chapter three is devoted. Chapter four includes the analysis of the developments in commercial banking and other financial intermediaries.

3.1 The East African Currency Board (EACB)

During the colonial period, when Britain established its control over a number of colonies in a given region, it usually formed a 'common currency area' among them. The currency areas formed in the British colonial empire were served by the so-called 'Currency Boards'.¹ Thus, after the World War I,

¹ For a thorough discussion of the monetary systems in the British colonial empire, and the currency boards in particular, See Newlyn and Rowan (1954).

when Britain took control over a number of countries in East Africa, it established the East African Currency Board (EACB).

The EACB was statutorily established in December 1919, but started its operations only after its terms of reference had been elaborated in Regulations issued in May 1920.² The Board was originally intended to serve Kenya, Uganda and Tanganyika.³ Like all the currency boards formed in the British Colonial Empire the purpose of the EACB was to provide for and to control the supply of currency to the respective territories in a manner that would ensure automatic redemption against sterling. For this purpose the EACB was required, by its constitution, to hold a reserve in sterling "more than sufficient for all the purposes for which such reserves may be required".⁴ In practice this was interpreted by the Secretary of State for Colonies (who was responsible for the operations of the Board), to imply more than 100 % and indeed the Board made no distributions of profit to member territories until this was achieved.⁵ The Board started its operations in a complex arena: in Tanganyika, for example, four main currencies were in circulation—the Indian Rupee, a more or less similar Silver coin issued by the German East Africa Company during the German rule (1893–1914), German token coins issued during the war (1914–1916), and local rupee coins issued by the British Currency Commissioners during the period of transition to British Mandate (1916–19).

The conversion of these currencies into the East African Shilling (EAS) that was issued by the Board was more or less completed in 1925. Due to the fall in silver prices, and hence the depreciation of the silver rupee (which was dominant in East Africa), the EACB incurred substantial losses in the conversion exercise.⁶ These losses, coupled with the world depression in the turn of 1930s, constrained the growth of the reserve fund of the Board during its early years of operation.

Chart 3.1 shows the movements in the reserve cover ratio of the EACB, defined as the ratio of reserves to currency in circulation.

As seen from Chart 3.1, the EACB had a relatively low reserve cover ratio at the end of the conversion operations in 1925. The ratio continued to deteriorate gradually and reached a minimum of 9.9 % in 1932—just at the

² See the EACB; *Report for the year ended 30 June 1921*, London 1922, Appendix I pp. 7–9.

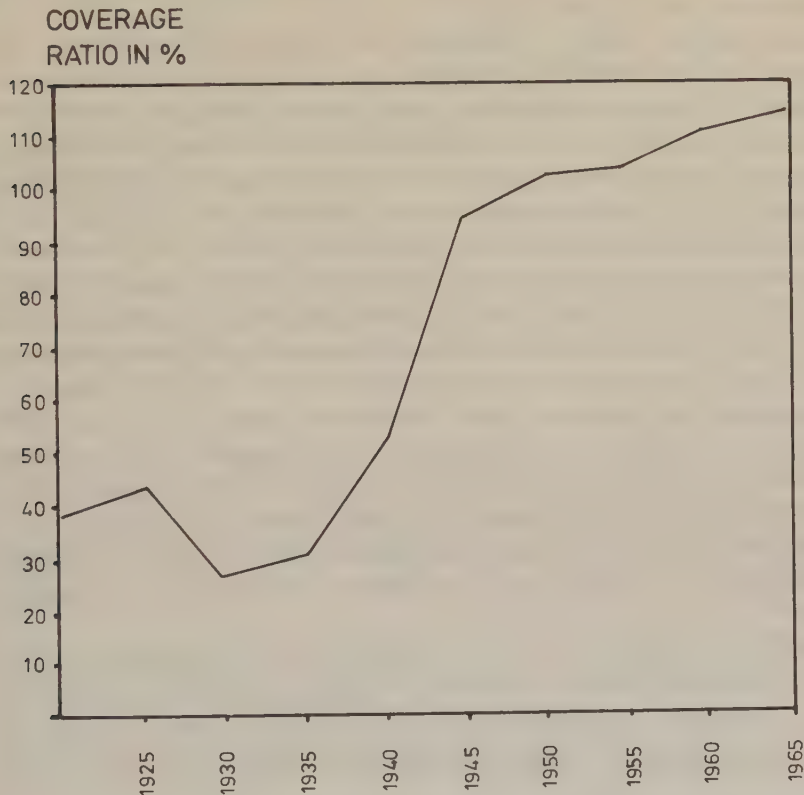
³ Zanzibar joined the currency area in 1936, followed by Ethiopia, British Somaliland, Italian Somaliland and Eritrea in 1942/43. Ethiopia withdrew in 1945, Italian Somaliland and Eritrea in 1950 and 1952 respectively. However, Aden joined the area in 1951. British Somaliland and Aden withdrew in 1961 and 1965 respectively, so that at the time of dissolution the Board had the same membership as it started. For more details on this issue, see Caselli (1975, pp. 27–28).

⁴ See Article 21 of EACB Regulations, in EACB Report for the year ended June 1921, *opt cit.*

⁵ Newlyn (1967, p. 29).

⁶ Sayers (1930, p. 192). See also Blumenthal (1963, pp. 2–3).

Chart 3.1. The EACB: Reserve Cover Ratio during 1925—65 (in percent). (Selected years, End of June Figures).



Source: Adapted from the Annex 3.1.

peak of the World depression. A downward movement was correspondingly recorded in the currency in circulation which had declined by over 36 % in 1932 as compared to the 1925 level. The reserve ratio picked up slowly after 1932, but did not reach the 100 % cover which was implicitly 'required' up to until 1950. Only after 1949/50 did reserve surpluses start to accumulate and indeed the EACB distributed its first dividends (being the net income earned on reserves) amounting to about EAS 3 million to its member countries in that year.⁷

⁷ The marketed change in the currency in circulation and reserves in 1944 should, above all, be attributed to increased membership of the Board (see Annex 3.1).

As a result of maintaining relatively high reserve cover ratios, and investing the reserves in foreign securities, the EACB channelled much of the "seignorage" out of East Africa.⁸

During the period 1919—55 the EACB, like all other Currency Boards, acted passively as an automatic money changer, guaranteeing the continuous convertibility of EAS into sterling and vice versa, without playing any active role in influencing the quantity of currency or local credit conditions. As measures for encouraging the indigenous population to undertake export production got implemented by the colonial government, especially after World War II, monetization of the East African economies took a rapid pace. As a result of increased cash-crop production and government efforts to promote development, the use of money and credit increased. This was particularly true of the cooperative societies which needed increased seasonal credit for crop purchases, and the private sector as a whole in response to the boosted demand for manufactures and tertiary services.⁹ On the other hand, peasants and other groups of the indigenous population, who got engaged in the expanding monetary activities may be assumed to have increased their accumulation of monetary (transferrable) surpluses. In response to the increased demand for intermediaries, several new banks opened branches in East Africa to compete with the "Big Three", i.e. the Barclays, the National and Grindlays and the Standard Bank.¹⁰

Evidently, by mid-1950s there was a need for more active participation of the EACB in the regulation of the money supply in East Africa, and for that purpose some of the elements of the EACB's constitution had to be relaxed to allow for some degree of monetary expansion consistent with rapid growth.

3.2 Changes in the Functions of the EACB during 1955—59

In September 1955, the Board's constitution was amended to provide for borrowing by the governments of the constituent territories from the Board. The amount that could be borrowed by each of the governments was confined to what was called 'fiduciary issue' limits. The provision for the 'fiduciary issue' had the effect of allowing the EACB to issue currency (within the specified

⁸ "Seignorage" is another word for the monopoly rent obtained from issuing money.

⁹ See the discussion in chapter 2.

¹⁰ See the discussion in chapter 4.

Table 3.1. EACB: Fiduciary Allocations to the Government of Tanzania.

(End of June Figures, in million EAS, except where given as %)

	1957	1959	1961	1963	1965
I: Total Authorized	56	114	112	112	198
II. (1) as percent of overall government budgeted revenue	14.4	26.2	23.4	18.8	27.6
III. <i>Utilization Ratio</i>					
Total (%)	36.0	19.0	79.0	91.0	63.0
of which:					
Treasury Bills	—	—	41.1	55.4	45.5

Sources: Adapted from Caselli (1975). The Overall Government Budgeted Revenue data were obtained from *Tanzania: Statistical Abstract, 1966*.

limits) against the securities of the governments and other specified intergovernmental organizations. As a result, the currency in circulation could, from thereon, increase without a corresponding rise in foreign exchange reserves.

The fiduciary issue limits for Tanzania (Mainland) and the percentages by which the issue was utilized in various years are presented in Table 3.1. In order to show the role that could be played by the fiduciary issue in financing the government, the ratio of the fiduciary allocation to overall budgeted revenue of the government for the respective years is also given.

The fiduciary issue for the whole of East Africa was initially limited to a maximum of EAS 200 million, which was revised upwards to EAS 400 million in 1957, then to EAS 500 million and finally to EAS 700 million in 1963 and 1964 respectively. Corresponding to these increases, fiduciary issue allocations to Tanzania (Mainland) rose from EAS 56 million in 1955—57 to EAS 198 million in 1965. As a percent of the total budgeted government revenue, the fiduciary issue rose from about 14 % in 1957 to 28 % in 1965.

The utilization ratio was relatively low prior to 1959, being below 50 %. This ratio rose sharply after allowing treasury bills to be included in the fiduciary issue in 1960.

3.3 The Adaptation of the EACB to the Requirements of the Consistent Countries in the light of their approaching independence (1960—63)¹¹

While retaining its basic principle of issuing and redeeming currency automatically on demand against sterling, the Board's Regulations were again revised in December 1961 to provide for two main changes in political and monetary situation of East Africa. These changes were brought about by: the attainment of independence by Tanzania (Mainland) on 9 December 1961; and the intensive capital flight, which started towards the end of 1950s as the prospects for political independence of Tanzania brightened (cf. Loxley (1979)). In connection with the latter, there occurred massive withdrawals from deposits of various financial institutions, including the commercial banks (see Chapter 4). At the same time, having, for security reasons, remitted part of their own investments overseas, foreign companies called on the commercial banks for more working capital. This created a relatively strong pressure on the demand for bank credit, which might have had adverse effects, especially on the procurement of export crops.

In response to the above two conditions, the EACB Regulations were amended to include:

- i) the transfer of the Board's headquarters from London to Nairobi, and appointment of representatives from member countries into the Board. This was intended to give the member countries more influence on the Board's decisions.
- ii) the introduction of a crop finance facility upon which the banking system could draw to meet seasonal peaks in demand for credit to finance agricultural inputs and purchases of export crops—coffee, cotton, sisal, tea, cloves, pyrethrum, cashewnuts and tobacco. Through this facility, the EACB could intervene considerably in the credit markets of its member countries, as it was then acting as a lender of last resort. The main weakness of this facility was the requirement that only "first class" bills could be discounted. Such bills were, however, beyond the reach of African farmers.

Nevertheless, during 1960—63, the commercial banks relied very little on borrowing from the Board for crop financing due to the relatively high rediscount rate of 7 %, and the quality of paper that could be discounted. Thus, during the period, the utilization of the crop facility introduced by the Board remained only at about 30 % of the maximum limit of EAS 100 million.

¹¹ Cf. EACB, Report for the Year Ended 30 June 1961 (especially p. 15).

3.4 Attempts to Restructure the EACB and the Creation of Separate National Central Banks

3.4.1 The Blumenthal Report of 1963

Immediately after Tanganyika's (Tanzania Mainland) independence in 1961, an expert from the German Federal Banks, Dr. Edwin Blumenthal, was requested by the Government of Tanganyika to study the East African monetary system and make proposals for its future.

From his report to the Tanganyika Government in 1963, it is implicit that Blumenthal saw East Africa as a political entity.¹² In short, he recommended the continuation with the East African currency area, with a supra-national central bank replacing the EACB, aided by state central banks.

The supra-national central bank was to be established at the regional level, and charged with the following responsibilities: the control of monetary reserves, foreign exchange management, the control of solvency and liquidity of the state banks, issue of general credit policy—including reserve requirements for the financial institutions, supervision of the banking system, banker to regional organizations (bodies) and the issue of currency. The state banks were to be established in each of the member countries mainly to safeguard the special interests of the specific country. Thus, the state banks were to be charged with the following duties: the supply of money within the country, banker to the respective government, bankers' bank—including last resort lending (with the backing of the supranational bank), and the implementation of the broad lines of monetary policy laid down by the regional central bank.

The officials of the EACB itself were very much in favour of the Blumenthal proposal, which involved mere restructuring of the Board. In this connection, they, in the EACB's Report of 1963/64, offered their view on how the Currency Board could gradually be transformed into the required 'supra-national central bank'.

¹² As a result, Blumenthal proposals differed only slightly from those of Newlyn. Newlyn's proposal corresponded to the Indian Reserve Bank model in which each of the constituent countries was to have a semi-autonomous central bank to expedite 'non-control' functions excluding external contacts and inter-regional coordination. "In addition there would be set up on a regional basis an East African Reserve Board which . . . would take over the functions of the EACB, and would have the power to control currency issues . . . Banking policy, on broad lines would also be determined by the Board. . . . Within these broad limits the territorial central banks would have some room for movement . . . The Reserve Board would implement its monetary policy through the powers of the territorial central banks" (Newlyn (1959, p. 68)).

3.4.2 The EACB Official Proposals

In its report, the Board forecast a long period of transition to monetary independence for the three countries, and committed itself to carry on as intensively as possible with its quasi-central banking services, while at the same time developing the functions and responsibilities of the territorial branch offices, and considering ways and means of easing the difficulties of government borrowing at short-term.

The Board suggested some amendments to its constitution to allow more flexibility in administration and introduction of new facilities and services of a central banking nature. The stress was on equipping the EACB with the means of influencing credit conditions more effectively. For that purpose it needed the powers to impose reserve and liquidity requirements, as well as the legal authority to obtain relevant information from the member countries.

In its constitutional proposals, the Boards suggested, *inter alia*, formation of a Board to cater for only the East Africa proper; the discontinuation of the formal involvement of the British Secretary of State in the affairs of the Board; the issue of currency with distinctive East African character; as well as the amendment of the powers of the Central Legislative Assembly of the EACSO (which came to form the East African Community) to include legislation on currency matters.

In addition, the report recommended the initiation of an East African credit instrument in form of a treasury bill guaranteed by the three governments, but issued by one agent (probably the EACSO), with a standing committee to determine global borrowing requirements and harmonize them with the territorial needs, and finally suggested the restriction of government borrowing to issues of such bills.

It was appropriately argued that such a system had the advantage of permitting greater support for the treasury bill market, facilitating an important range of central bank functions, and enhancing a more intensive deployment of excess cash reserves of banks and other financial institutions, as well as allowing a greater float of treasury bills to be carried with safety, while at the same time promoting a more equitable sharing between the three countries of the short-term funds available in East Africa as a whole.

The two-tier monetary system for East Africa (supra-national central bank and state banks) proposed by Blumenthal, and the East Africa treasury bill instrument, proposed by the EACB officials, had one major advantage: economies of scale. In other words, a central bank serving a wide geographical area (East Africa) would have economized the costs of fulfilling the central bank functions by separate national central banks taken together. Moreover, a common treasury bill instrument for the whole of East Africa would have permitted a greater float of treasury bills to be carried with safety, and probably a more

intensive deployment of loanable funds in the three countries.

However, the plausibility of the two proposals seemed very much tied to the assumption that political federation among the countries was just 'around the corner'. As the prospects for federation weakened, in the course of 1964, the two reports became unpopular. Emphasis was placed on the negative effects that could arise from a currency area for the whole of East Africa. Reference was made to, among other things, the unevenness in financial development among the three countries—in favour of Kenya—during the 1950s. It was also argued that a common currency area for the region would imply an immense subordination of each country's economic policy to supra-nationally designed monetary policy. This is because, as advanced by Thirwall (1974), under conditions of poorly developed money and capital markets, there tends to be a close interaction between monetary and fiscal policies. This would have been a great disadvantage, especially in the period when economic policies of the three countries differed radically from each other.

3.5 The Formation of the Bank of Tanzania in 1966

Following the declaration, in June 1963, by the East African countries of the intention to form a political federation, it was decided to carry on the negotiations on the formation of an East African central banking system (more or less as proposed by Blumenthal) alongside those of political union. However, by the end of 1963, nothing seemed to materialize on the political front. It was therefore decided by the governments to carry the negotiations regarding the formation of a central banking system, separate from those of political federation.

Thus, in 1964, the three governments requested the IMF to send a mission to advise them on the setting up of an effective central banking system in the region.

The discussions among the three East African countries and the IMF team took place in February 1965. The Tanzanian official position in the discussions centred on three major points: first, it was customary for all sovereign governments to control their financial systems and regulate the general level of activity in their economies through own central banks; second, the creation of a unified central banking system was going to require a complicated and delicate financial mechanism and regulator; and third, the sharing of foreign reserves, and the need to coordinate price and interest rate policies were likely to encounter a divergent range of economic pressures, which could create political tension.

The actual results of the negotiations with the IMF team became apparent

in the budget speeches of the three countries on 10 June 1965 and in the subsequent explanations such as those given by Tanzania's Finance Minister of that time, Hon. Paul Bomani.¹³ Following the pronouncements, the Tanzania Parliament passed a bill on 4 December of the same year which was approved on 6 January 1966 to become an:

“Act to provide for the establishment, constitution, and functions of the Bank of Tanzania as a Central Bank, to provide for the currency of Tanzania, to provide that the Bank shall be Banker to the Government and shall have certain powers in relation to the other banks and financial institutions, to extend the Banking Ordinance to Zanzibar and to make certain amendments to the law relating to Banking and Exchange Control”.

3.6 The Monetary Effects of the EACB Break-up

The restriction of the EACB as a monetary authority to the issue of a currency fully redeemable against sterling had rendered the Board impotent to pursue an independent monetary policy during the period 1919—1955. However, after 1955 the Board enlarged its competence by amending its Constitution, first to allow the introduction of the fiduciary issue, and later to permit the introduction of the crop finance facility, both of which gave it some room to conduct monetary policy, though limited in scope by the Board's inbuilt institutional rigidity. The main constraint on the currency board system throughout its history in the conduct of monetary policy was its inability to engage in a continuous process of credit creation such as might have been consistent with growth requirements of the respective economies. This is exemplified by the fact that by June 1965 the EACB still maintained 82 % reserve cover, while the commercial banks, having increased their lending to domestic sectors by more than five-fold during 1950—65, had an advance ratio (the ratio of advances to the private sector to deposits) of 100 % and negative reserve cover (Newlyn (1966, pp. 1—2)).

This situation had the effect of constraining the money supply and savings deployment for at least one reason: in the absence of a central bank the money supply remained entirely dependent on the balance of payments as the expansion of it could no longer be attained by enlarging commercial bank credit. As a result, the money to GDP ratio more or less stagnated over the period 1950—65, despite the rapid increase in the number of financial intermediaries (see Table 3.3).¹⁴

¹³ Ibid. See, Radio Address by Hon. Paul Bomani, Minister for Finance, 13 June 1965.

¹⁴ The development of other financial intermediaries is discussed in chapter 4.

Table 3.2. TANZANIA: Money Supply (M1 and M2) to GDP Ratios, Selected Years (in percentages).

Ratios to Nominal GDP	1950	1955	1960	1965
M1 (Currency in circulation + Commercial Bank Deposits)	24.7	27.4	21.7	24.1
M2 (M1 + Non-commercial bank Deposits)	26.6	29.4	23.3	26.1

Sources: Deposits figures are from Annex Table 9.2. GDP figures for the period 1950—55 were estimated on basis of the data presented by Ord (1962). For the rest of the period, the GDP data were obtained from Tanzania: Statistical Abstract, various issues.

Table 3.3 suggests that both the monetary system (the issuing authority plus the commercial banks, responsible for M1) and the financial system as a whole (responsible for M2), may at best be characterized as having stagnated over the period 1950—65. It would be of interest to inquire into the financial institutions that were responsible for this stagnation or retrogression (at worst). This is one of the aims in the next chapter.

Concluding Observations

In concluding this chapter, I recapitulate that the EACB was an issuing authority, mainly for the East African territories (Tanzania, Kenya and Uganda). It guaranteed full convertibility of the currency it issued for circulation in these countries by maintaining a more or less 100 % foreign exchange reserve cover (held in British securities) against it. For this reason, it may be referred to as an 'automatic money changer'—from sterling to local East African currency (EAS). In connection with this, it has been noted, in the foregoing discussion, that the 'seignorage' of the currency issue in East Africa was almost totally channelled abroad by the Currency Board. Moreover, the money supply, prior to the introduction of the fiduciary issue (1955) and treasury bill issue (1961), was entirely determined by balance of payments performance.¹⁵

Another point to be noted from the discussion in this chapter is that despite the attempts by the EACB to fulfil a number of functions usually performed by central banks, especially as the constituent countries approached their political independence in early 1960s, it principally remained an 'automatic money changer'. Further, efforts to restructure the Board into a supra-national central bank for the whole East Africa were seen as politically inconsistent with the desire for national sovereignty in the conduct of monetary policy by the independent national governments.

¹⁵ It should be remembered that the fiduciary and treasury bill issues were very limited, and had little impact on the money supply.

The main effect of the EACB's rigidity in the issue of currency was a more or less stagnation of the money supply to GDP ratio for Tanzania during 1950—65.

Judging from the rapid growth of indigenous small-holder participation in cash crop production during the 1950s (see Chapter 2), it may be argued that a crucial strategy for financial development during 1950—66 had to concentrate on the promotion of agricultural credit to the small-indigenous farmers. This could be achieved if the crop financing facility, introduced by the Board, was designed in a manner that was accessible to the small farmers. However, many of the changes that took place in the EACB during the period did not induce credit extension to the indigenous sector.

Chapter Four

Tanzania's Financial Experience in the Post-War Period up to 1965

Introductory Remarks

The main financial characteristic of the period 1950—65 was the stagnation in the deposits to GDP ratio. This ratio, as seen from Table 4.1, fell from 17.7 % in 1950 to 12.3 % in 1960 and then increased again to 17.8 % in 1965. This development is paradoxical considering the degree of financial widening and the lengthening (the growth of specialized financial intermediaries and instruments) that was recorded in the period 1950—65 (see Table 4.2). Theoretically, one would have expected the deposits to GDP ratio to improve in the light of the increase in number of financial intermediaries and their diversification.

This chapter is intended to offer some insights into the causes for the decline (or at best—stagnation) in the deposit to GDP ratio, which is an important measure of the degree of financial intermediation. With this main purpose in mind, I shall attempt to describe the widening and the lengthening of the financial sector that took place in Tanzania in the post-war period, up to 1965, and in the course of this, describe the financial institutions that were responsible for the stagnation in the deposit to GDP ratio. Related with deposit mobilization, is the extent to which the financial institutions invested the resources they mobilized in the domestic sectors of the economy. In the course of this chapter, therefore, I shall also attempt to discuss to what extent the financial system during 1950—65 acted as a mechanism for channelling funds abroad.

Space limitation does not allow a thorough discussion of each of the intermediaries that operated in Tanzania during the period of our interest. As seen

Table 4.1. TANZANIA: Deposits to GDP Ratios, Selected Years, 1950—65 (in percentages).

	Deposits as at End of the Year			
	1950	1955	1960	1965
Ratio to GDP of Total Deposits of financial Institutions	17.7	16.0	12.3	17.8

Source: Calculated from Annex 9.2, with GDP figures obtained as per Table 3.3.

Table 4.2. TANZANIA: Financial Structure as represented by Shares of Various Institutions in Total Financial Assets, Selected Years, 1950—65 (in percentages).

FINANCIAL INSTITUTIONS	Assets as at End of Year			
	1950	1955	1960	1965
1. East African Currency Board (EACB)	31.0	42.1	34.9	25.5
2. Commerical Banks	55.7	43.8	34.2	48.7
Total Monetary Institutions (1 + 2)	86.7	85.9	69.1	74.2
3. Post Office Savings Bank	5.7	5.4	2.9	1.8
4. The Land Bank	0.7	1.1	2.2	--
5. Agricultural Loan Funds	0.1	0.1	0.1	--
6. Agricultural Credit Agency/National Development Credit Agency (NDCA)	--	--	--	3.1
7. National Cooperative Bank (NCB)	--	--	--	3.2
8. Marketing Boards	0.5	1.1	2.7	2.2
9. Cooperative Societies/Credit Unions	1.1	2.4	5.7	4.6
Total Specialized Agric. Credit Institutions (4 + 5 + 6 + 7 + 8 + 9)	2.4	4.4	10.7	13.1
10. Tanganyika Finance Company (TAFCO)	--	--	--	0.0
11. National Development Corporation (NDC)	--	--	--	0.6
12. Tanganyika Dev. Finance Co. Ltd (TDFL)	--	--	--	1.2
13. Mwananchi Development Corporation (MDC)	--	--	--	0.3
14. Workers Development Corporation (WDC)	--	--	--	0.2
15. Diamond Jubilee Investment Trust	--	--	--	1.3
16. Industrial Promotion Services (IPS)	--	--	--	0.3
17. Instalment Credit Institutions	--	0.1	0.8	0.9
18. National Small Industries Credit	--	--	--	0.1
Total Specialized Industrial Credit Institutions (10 + 11 + 12 + 13 + 14 + 15 + 16 + 17 + 18)	--	0.1	0.8	4.9
19. First Permanent Building Society	--	--	11.8	--
20. National Housing Corporation (NHC)	--	--	--	1.0
21. National Provident Fund (NPF)	--	--	--	2.0
22. Insurance Companies	5.2	3.9	4.6	3.2
Total Contractual Savings Inst. (21 + 22)	5.2	3.9	4.6	5.2
TOTAL ¹	100.0	100.0	100.0	100.0

Notes: 1) The Figure might not add up to this total due to rounding. -- stands for NIL, . . stands for Not Available.

Source: Calculated from the Annex 9.2.

in Table 4.2, presenting the changes in the financial structure of Tanzania during 1950—65, commercial banks were the dominant financial institutions in the country, accounting for between 35—55 % of the total financial assets in the selected years. By significance, reflected by the share in the total financial assets, the second place was occupied by agricultural finance institutions, followed by the Post Office Savings Bank. Most of the other financial institutions were less significant, accounting for less than 2 % in the financial structure when taken singly, and evolved in the course of the period, 1950—65.

In this chapter, I shall limit myself to giving detailed account of the three main financial institutions during the period under review. The other financial institutions will be grouped under 'miscellaneous' and surveyed only briefly.

4.1 Development of Commercial Banking in Tanzania up to 1965

The Deutsche Östafrikanische Bank was the first commercial bank to open its doors for business in Tanzania in 1905. With the issuing privilege conferred to it by the German government it performed, inter alia, the central bank functions of currency issue and banker to the government. In 1911, the Handelsbank für Ostafrika opened a branch at Tanga, but it acted exclusively as a commercial bank without any rights of issuing currency.

Immediately after the defeat of the Germans in the World War I, three bank cartels of British origin were established to replace the German banks. These came to be popularly known as "The Big Three" and included:

- a) The National and Grindlays Bank, an amalgam of the Grindlays Bank, the National Bank of India, and the South-Asian 'Eastern' branches of the Lloyds Bank;
- b) The Standard Bank; and
- c) The Barclays Bank D.C.O.—a merger of the British Colonial Bank (founded in 1836), the Anglo-Egyptian Bank (formed in 1864), and the National Bank of South Africa (founded in 1890).

"The Big Three" dominated the banking scene of Tanzania up to 1950. In 1951, the Nederlansche Handel-Maatschappij established itself in East Africa.¹ The bank opened two branches in Tanzania, through which it con-

¹ In 1964, the Nederlandsche handel-Maatschappij was renamed the Algemene Bank Nederland (The General Bank of Netherlands), after merging with the Twentsche Bank N.V.

ducted over half of its business transactions in the region. Other banks followed suit.

Thus, in 1953 and 1954, two Indian-based banks—the Bank of India and the Bank of Baroda, respectively—each opened a branch in Dar es Salaam, while the latter opened branches in Moshi and Mwanza as well. These were followed by an Anglo-French institution, the Ottoman Bank, which established branches in Dar es Salaam, Kigoma and Moshi in 1958; and then by the Commercial Bank of Africa (belonging to an international group of bankers) in 1961, and finally (on the lift of foreign owned banks) by the National Bank of Pakistan in 1962. The latter two institutions had branches only in Dar es Salaam.

In response to the failure/negligence of the colonial banking system in mobilizing and deploying funds to the traditional sectors, immediately after independence the government embarked on what Loxley (1979) terms “policies of nationalism in the monetary sector”. These policies included the formation of new institutions designed to compete with or complement the foreign owned financial institutions. In the field of commercial banking, the government promoted the creation of the National Cooperative Bank (under the aegis of the Agricultural Credit Agency, ACA) in 1962, and the Tanzania Bank of Commerce (TBC) in 1965. The former was designed to take up (partly or wholly) seasonal crop finance and the deposit business of the cooperatives from the foreign banks.

The Tanzania Bank of Commerce, was initiated by the government as a national bank to compete with the expatriate ones, and was established as a result of the purchase of the assets and liabilities of the Ottoman Bank by the government. It had a fully paid up initial capital of TZS 10 million, of which 60 % was subscribed by the government and the rest taken up by the other commercial banks operating in the country.

The Peoples Bank of Zanzibar, although exclusively dealing in the Island part of Tanzania, is worth mentioning. The Bank was created by the Zanzibar Companies Decree of 1966, with fully paid-up capital of TZS 16 million wholly subscribed by the Zanzibar Government. The Peoples Bank of Zanzibar, PBZ, initially confined its activities to the taking over of the operations of the National and Grindlays Bank as the government’s banker and financiers of the State Trading Companies established in Zanzibar in 1967. As a result, the branches of the National and Grindlays Bank and the Standard Bank in Zanzibar were rendered dormant. However, up to December 1966, the PBZ had not established financial relations with the general public, probably in anticipation of charging it with central bank functions in case the formation of a currency union with the mainland, which was under discussion, proved a failure.

4.1.1 From Laissez Faire to the Banking Legislation of 1960

Of the three East African territories, Tanzania was the last to introduce legal regulations in the business of banking.² However, the banks managed to operate relatively soundly in laissez faire before the Banking Ordinance of 1960. The main explanation is that all the banking institutions operating in the country up to 1960 were branches of multinational banks, strictly controlled from their head offices overseas.

An analysis of the provision of the Banking Ordinance of 1960 (Cap. 430) suggests that this legislation, enacted before there was a national central bank, was intended to protect depositors.

The Act defines the business of banking as “the business of receiving money on current account subject to withdrawal by cheque” and provides that only a company or a cooperative society licenced by the Registrar of Companies may perform such business. According to the Ordinance, registration for banking business requires a minimum paid-up capital of TZS 2 million. Moreover, banks were required by the law to invest at least 25 % of their annual income in stocks and bonds of the East African governments; and subjected to inspection by the Registrar of Companies.

However, the Act does not impose any regulations on the liquidity of banks, and although this might have looked irrelevant in the background of the banking scene under which it was designed—dominated by expatriate banks that could easily call upon their head offices for extra cash—it remains a shortcoming in a legislation, enacted at the time when there were already strong tendencies towards the formation of indigenous banking institutions.

4.1.2 Interbank Relations

With the main objective of avoiding competitive pressure and maintaining what one may call the ‘equilibrium state’ between the pioneers of banking in East Africa, i.e. “The Big Three”, these institutions in 1929 signed an agreement that defined in detail the main types of business and the minimum charges. The cartel was formalized in what was known as the ‘Summary of Banking Arrangements’ (see Pauw (1970, p. 196), Blumenthal (1963, pp. 17—18)).

The ‘new-comer’ banks that entered the East African scene in 1950s, were forced to conform to these arrangements if they wanted clearing house membership. The latter was important as a precondition for the new banks to take part with full rights (i.e. without discrimination) in the payments transactions which were dominated by “The Big Three”.

² Uganda introduced a banking legislation in 1955 (Uganda Laws, Cap. 88), while Kenya introduced its banking ordinance in 1956 (Kenya Act No. 62 of 1956).

Table 4.3 (a). TANZANIA: Commercial Banks—Sources and uses of funds, Selected Years, 1938—65 (End of Year Figures).

	1 Million TZS									
	1946*	1956	1958	1960	1961	1962	1963	1964	1965	
I. LIABILITIES (Sources)										
1. Domestic Deposits										
(Total)	189,0	404,7	401,2	390,7	552,1	641,1	702,9	755,2	897,2	
of which:										
1.1 Demand deposits	164.5	292.2	289.1	296.9	427.1	498.4	498,4	564.1	662.6	
1.2 Time deposits	16.1	75.8	67.2	44.0	73.3	96.2	124.0	101.7	132.4	
1.3 Savings deposits	8.4	36.7	44.9	49.8	51.7	60.7	80.5	89.4	102.2	
2. Other Liabilities	1.2	25.9	24.6	38.5	36.1	51.0	50.7	77.6	88.3	
TOTAL LIABILITIES	190.2	430.6	425.8	429.2	588.2	692.1	753.6	832.8	985.5	
II. ASSETS (Uses)										
3. Cash Holdings	21.1	30.0	31.7	41.3	24.0	33.5	32.9	44.5	32.4	
4. Net Lending to other Banks, Total	150.0	186.6	148.1	10.3	78.3	96.4	130.9	40.9	—2.2	
5. Lending to Domestic Sectors, Total	17.7	184.7	203.0	313.3	391.1	465.7	466.0	632.6	863.2	
6. Other Assets	1.4	29.3	43.0	64.3	94.8	96.5	123.8	114.8	92.1	
TOTAL ASSETS	190.2	430.6	425.8	429.2	588.2	692.1	753.6	832.8	985.5	

Source: Adapted from Annex 4.1.

* Includes Zanzibar.

The conditions laid down in the "Summary of Banking Arrangements" required the member banks to coordinate their activities to ensure common interest rates, exchange rates, discriminative policy against clientele (particularly local relative to foreign), and a clearing arrangement.

One of the main targets for criticisms against the 'Summary' has been its provision with respect to agricultural credit. Thus, according to the arrangement, the banks were supposed to charge a 'finance fee' of about 0.25 % on seasonal crop finance, over and above the normal interest rate.³ This was probably a rational thing to do, however, in the light of high risk of default in the agricultural sector as compared with other sectors (see section 4.3).

4.1.3 Analysis of Commercial Bank Activities in the Post-War Period Up to 1965

Table 4.3 (a) gives the consolidated balance sheet of the commercial banks operating in Tanzania during the post-war period up to 1965. From the

³ This was particularly true for cotton financing.

Table 4.3 (b). Sources and uses of Commercial Bank Funds in Tanzania, 1946—65 (Percentage composition, Annual Averages).

End of Year	Share in Total Sources		Share in Total Uses (Assets)		Uses by Sectors		
	Domestic Deposits	Other Liabilities	Domestic Lending	Total Domestic Assets (incl. domestic loans)	Foreign Assets	Private	Public
1946	99.4	0.6	9.3	21.2	78.8	..	..
1956	94.0	6.0	42.9	49.8	50.2	..	..
1958	94.2	5.8	47.7	55.0	45.0	..	..
1960	91.0	9.0	73.0	83.0	17.0	..	..
1961	93.9	6.1	66.5	70.6	29.4	70.2	29.8
1962	92.6	7.4	67.3	73.6	26.4	75.4	24.6
1963	93.3	6.7	63.5	68.3	31.7	83.2	16.8
1964	90.7	9.3	76.0	82.2	17.8	76.2	23.8
1965	91.0	9.0	87.6	93.3	6.7	73.2	26.8

Source: Adapted from Annex 4.1.

liabilities side, it may be seen that domestic deposits—mainly demand deposits—formed the major source of funds for the commercial banks during the period under review. The assets side shows that up to the mid 1950's, a dominating share of bank funds was held abroad. Domestic lending increased rapidly during the postwar years, however. The main items in the sources and uses of funds by the commercial banks are discussed in more detail in the following two sub-sections.

Deposit Activities

Table 4.3 (b) presents a consolidated analysis of the sources and uses of funds for the commercial banks operating in Tanzania during 1946—65. In 1946, domestic deposits accounted for about 99 % of total liabilities. In the years that followed, the structure of the liabilities changed slightly, reflecting increased investment opportunities in the country during the 1950s. The share of other, mainly foreign, liabilities in the total liabilities of the commercial banks increased uninterruptedly throughout the period 1950—60. By 1956, the proportion of domestic deposits in the liabilities of the commercial banks had declined to 94 % and by 1960 it had fallen to 91 %.

As Binhammer (1969d) argues, rapid mobilization of deposits was recorded only in the post-World War II years. This was due to restricted lending opportunities coupled with easy access to external finance via their parent institutions, and absence of foreign exchange restrictions prior to 1945. However, developments in the real economy, such as the persistence of a relatively large subsistence sector, low income growth during the interwar period, and cultural

factors, including the attitudes of the indigenous population to the banks, also contributed to the sluggishness in deposit growth prior to the World War II (see Chapter 2).

Nevertheless, immediately after the war, deposit mobilization by the commercial banks intensified. This was mainly due to the groundnut scheme and the introduction of government development planning in 1946, as well as the rapid shift from subsistence to monetary economy, and increase in number of commercial bank network in early 1950s (cf. Chapter 2). As far as the latter factor is concerned, it is of interest to note that the number of commercial bank offices in Tanzania rose from 16 in 1925 to only 19 in 1946, and probably much more rapidly thereafter—due to the entry of new banks to compete with “The Big Three”.⁴ In 1964, there were 59 banking offices in Tanzania (Mainland), of which 49 belonged to “The Big Three”, and at the time of bank nationalization (1967) the number had risen to 68.⁵

The factors mentioned above widened investment and savings opportunities in the country, especially in the years immediately after the war. As a result, the ratio of commercial bank deposits to GDP rose from about 12 % in 1946 to 16 % in 1950. Thereafter, the ratio declined gradually to about 11 % in 1960 and finally picked up again to about 16 % in 1965. While the capital flight, associated with the political climate, may explain most of the fall in the deposit mobilization function of the commercial banks during 1950—60, a contributing reason may be the failure of the banks in attracting deposits from the traditional sector of the economy (see Chapter 9).

4.1.4 Analysis of the Uses of Funds by Commercial Banks, 1946—65

The structure of assets held by the commercial banks in Tanzania is also shown in Table 4.3 (b). The proportion of domestic lending by way of loans, advanced and bill discounting was strikingly low in the years immediately after the War, as low as about 9 % in 1946, when measures on a “stock” basis. This ratio improved considerably in the 1950s, however, and settled at a high of 73.0 % in 1960. If total domestic assets of the banks are defined to include not only loans, but also cash reserves and balances due to other financial institutions in Tan-

⁴ Consistent data on the number of banking offices during the 1950s do not exist, but as Blumenthal (1963) notes:

“During the past few years (1946—59), the commercial banks, going back on the principles they followed, have opened more and more branch offices also at relatively small towns, and are even handling savings business by means of mobile units” (p. 7).

My estimate for the number of banking offices in Tanzania in around 1950 is about 40.

⁵ There were only 4 commercial bank offices in Zanzibar.

zania, then the ratio of domestic assets held by the banks to their total assets rose from 21.2 % in 1946 to 83.0 % in 1960 indicating that lending to domestic sectors had increased faster than the other elements.

The relatively small proportion of domestic assets in the total assets of commercial banks up to the middle or end of the 1950's reflects the paradox that the banks had exported capital irrespective of the relative scarcity of that factor in Tanzania.

Several factors may be advanced to explain why the banks in the early post war years chose to hold a large part of their assets abroad. First, bound by tradition, the banks were reluctant to expand their local lending activity much beyond the provision of self-liquidating commercial credit. As a result, they responded to requests for working capital and other short-term accommodation only when the borrower could offer 'first class' collateral, preferably sterling assets. This condition implied that most of the local entrepreneurs (Africans) had limited access to loans. Second, granted the existence of the East African currency union, the banks could, without any exchange risk, easily deploy their funds in other East African countries, especially in Kenya, where the money and capital markets were getting more rapidly developed. Moreover, in the absence of foreign exchange control, the funds could easily flow to the London market. The data is not detailed enough to allow one assess which one was the main leakage—to the rest of East Africa or to the London market. However, the evidence provided by, among others, Newlyn (1966, pp. 1—2) and Caselli (1975, p. 79), suggest that the overall position of the East African commercial banks prior to 1960 was one of 'net exporter' of funds. Only from 1960 did the Kenyan banks get overdrawn, and thus could not have formed a permanent leakage of Tanzania's savings during 1950—60. The London market was therefore the main centre to which the funds flew.

A few words are in order with regard to the increase in local lending by the commercial banks during the period 1950—65. After the war, the rapid expansion of the economy (see Chapter 2) opened up more profitable investment opportunities in the country. Further, in the latter years of 1950s, prospects for political independence became bright and most of the banks took a more liberal approach to lending domestically, in an attempt to identify themselves more closely with Tanzania. This included, for example, allowing local managers to have more discretion in the amount and type of their lending operations, as well as permitting some advances to Africans for the purchase of agricultural inputs (see Binhammer (1969, p. 3)).

Another important factor explaining the increase in commercial bank lending to domestic sectors, especially agriculture, from 1960 onwards, was the introduction of the crop finance facility by the EACB in 1960 (see Chapter 3).

Finally, Loxley (1979) has also explained the increased domestic lending by commercial banks in early 1960s by suggesting that the general capital flight

led to increased reliance on bank accommodation for working capital, which in turn pushed up the short-term lending rates and made it quite profitable for the banks to lend domestically. This explanation seems plausible in explaining part of the increase, especially if it is recognized that much of the funds which were remitted overseas by foreign companies for security reasons as independence approached, were of working capital character.

The high level of domestic lending in the years after 1964 was partly due to the introduction of exchange control in 1965, and disintegration of the currency union among the East African countries in 1966 (see IMF, *Survey of African Economies* (1969)). Both of these minimized the possibilities of the banks to deploy their funds abroad.

An important characteristic of domestic lending by commercial banks during the period under review is that it was mainly directed to the private sector. Thus, for example, during 1961—65, the share of the private sector in the total loans extended to domestic sectors was above 70 % (see Table 4.3 (b)).

4.2 The Post Office Savings Bank (POSB)

The Tanganyika Post Office Savings Bank (POSB) established by an Ordinance of December 1926 was statutorily charged with the duty of providing “a ready means for the deposit of savings and so encourage thrift”.⁶

The Ordinance required that the savings mobilized by the POSB be invested entirely in government securities. Thus, the monetary liabilities of the POSB, forming its sources of funds, are almost wholly made up of savings deposits, while the monetary assets are mainly government securities.

A simplified view of the sources and uses of funds by the POSB is presented in Table 4.4 (a). The table shows that the deposits mobilized by the POSB grew up to 1955, after which they gradually declined, reaching more or less the same level in 1966 as in 1950. Needless to say, corresponding trends were registered in the holdings of government securities by the institution. The remainder of this section is devoted to some more discussion of deposit mobilization and investment activities of the POSB during 1950—66.

Deposit Mobilization by the POSB

According to the Ordinance, individual deposits with the POSB were guaranteed by the government and each account was restricted to a maximum

⁶ See, Post Office Saving Bank Ordinance, 1926.

Table 4.4 (a). The POSB: Sources and Uses of Funds (end of Selected Years)
(in TZS million).

LIABILITIES/ASSETS	1950	1955	1960	1966
I. LIABILITIES (Sources)				
Savings Deposits	35.7	52.1	32.7	35.1
TOTAL LIABILITIES*	35.7	52.1	32.7	35.1
II. ASSETS (Uses)				
Cash in Hand	7.1	10.4	6.5	7.0
Government Securities**	28.6	41.7	26.2	28.1
TOTAL ASSETS	35.7	52.1	32.7	35.1

Notes: * Income from investments is another source of funds for the POSB, but it has contributed negligibly to the source of funds in the period.

** Up to 1960, the government securities held were mainly those of British Government, but after independence in 1961 there was gradual shift to the national government securities. However, detailed data were not available for the breakdown.

Sources: 1) Tanzania: Statistical Abstract, Various Years. 2) BOT: Economic and Operations Report, 1967.

Table 4.4 (b). The POSB: Selected Indicators of performance in selected years during 1950—66 (Values are in TZS, 000).

End of Year	No. of Depositors (,000)	End of Year balance	Aver. amount per Deposit	Ratio of POSB deposits to GDP (in %)
1				
1950	59,5	35692	600	1.6
1952	69,4	42913	618	1.5
1954	79,0	48208	610	1.7
1955	86,2	52107	604	1.7
1956	91,8	50604	551	1.7
1958	108,5	44507	410	1.3
1960	128,1	32721	255	0.9
1962	152,2	31239	205	0.7
1964	176,9	33932	192	0.6
1966	200,7	35076	174	0.5

Sources: 1) Tanzania: Statistical Abstract, various years.

2) Bank of Tanzania: Economic and Operations Report, 1967.

of TZS 10,000—implying that it was essentially meant to mobilize savings from small savers. The deposit rate of interest was initially set at 3 % per annum, but was reduced to 2.5 % after the second World War. The rate was maintained at that level up to 1969, when it was raised again to 3 %.

The performance of the POSB in savings mobilization during the period 1950—1966 is summarized in Table 4.4 (b).

As seen from Table 4.4 (b) the deposits mobilized by the POSB increased uninterruptedly during the first half of 1950s, registering an average annual growth rate of 9.2 % during 1950—55. However, from 1956 the deposits declined until 1962, when a recovery started. The decline in the average amount per deposit during 1950—66 (Table 4.4 (b)), may be explained by a change in the 'quality' of depositors. Evidently, the extension of the POSB's branch network into rural areas attracted new savers, most of whom were Africans with potentially lower average savings, by virtue of their lower incomes in relation to the Europeans and Asians. Two other explanations of the decline in the POSB deposits during 1950—62 have been advanced by Loxley (1968), viz: increased competition from the commercial banks, which extended their network to relatively remote areas, coupled with the rapid growth of other financial intermediaries (see Table 4.2); as well as the capital flight—thought to have cost the POSB almost half of its average annual deposit balances.

Due to the low rate of interest offered by the POSB on its deposits, relative to the commercial banks—for example—sizeable losses were sustained, especially after 1956.⁷ These losses were mainly due to the restriction of the POSB's investment opportunities by the provisions of its 1926 Ordinance, according to which the institution had to invest the savings mobilized mainly in British Government securities. As a result, the POSB held over 80 % of its total assets in British Government securities, bearing low interest rates (of 2.5—4.0 %) throughout its existence up to 1966.⁸ During the same period, the management costs of the POSB rose considerably due to increased number of depositors and decreased average size of accounts (Table 4.4 (b)). The POSB could not have switched its portfolio to local securities immediately after independence, when the Ordinance was relaxed to allow the holding of securities issued by any of the East African governments, mainly because the rates on the securities held had fallen considerably in early 1960s. Moreover, local securities

⁷ For comparison, the rate offered by commercial banks was 0.5 % higher, and those offered by building societies and hire purchase companies 2—3 % higher than that offered by the POSB on savings deposits (see Pauw (1970)).

⁸ Amongst the securities held by the POSB were the War Loan and Savings Bonds issued by the British Government, and some British public undertakings like the British Gas and the British Electricity, as well as by a number of Commonwealth countries.

were limited, and the constitution of the POSB deprives it of lending activities. However, during the period, 1950—66, the POSB sustained losses amounting to some TZS 6.3 million (equivalent to more than a third of its average annual in-payments) as a result of premature selling of the low-priced securities in order to procure funds necessary to repay deposits (especially at the time of the capital flight), or in attempt to gradually shift to securities with higher yields following a relaxation in the Ordinance after independence.

It is also evident from Table 4.4 (b) that during the period 1950—66 the growth of the POSB liabilities lagged behind that of monetary GDP. As a result, the ratio of POSB total liabilities to monetary GDP declined from 1.6 % in 1950 to 0.9 % in 1960, and to less than one percent in 1966. Thus, given the ratio of financial assets to wealth (or GDP) as a measure of financial development, it should be concluded that in terms of the two main depository intermediaries—the commercial banks (Annex 4.1) and the POSB—there was no real financial development during 1950—66.

The evidence of the POSB, which made a commendable effort to expand its branch network to rural areas, suggests that the extension of branch network by financial intermediaries to rural areas is not a short-cut to increased savings mobilization. For such a policy to be conducive to increased financial savings it must be supported by competitive yields on the financial assets offered by the respective intermediaries.

4.3 Development of Specialized Financial Institutions Prior to 1967

A General Comment

Specialized financial institutions—mainly formed by the support of government—are usually intended to speed up the process of financial intermediation in specific key sectors of the economy, where intermediation by private profit making institutions is believed to have been retarded by the existence of special risks. Such institutions are expected to develop skills in assessing the risks peculiar to the specified sectors, as well as ways for minimizing them.

In another context, specialized financial intermediaries may be seen as instruments for mobilizing funds and channelling them into specific sectors with little, or no access to bank credit.⁹

⁹ The banking system finds extra risks in extending credit to such sectors, at their usual rates of interest, i.e. without an extra risk premium.

In the developing countries, in general, specialized financial institutions are financed either by subventions from the government and external aid donors, and/or by deposit mobilization. In Tanzania, prior to 1967, only a few of the specialized institutions raised funds through deposit mobilization. This will be evident from the discussion in the following sections.

4.3.1 Agricultural Credit Institutions prior to 1967

In Tanzania, where agriculture is the dominant economic activity, agricultural (rural) credit is an important ingredient to economic development.¹⁰ This was recognized back in 1950s, when the colonial government spearheaded the formation of the following institutions to specialize in the provision of agricultural credit:

- a) cooperative societies and marketing boards;
- b) the Local Development Loan Fund (LDF);
- c) the African Productivity Loan Fund (APLF); and
- d) the Land Bank of Tanganyika.

I now turn to a brief discussion of each of these institutions.

a) Cooperative Societies and Marketing Boards

Cooperative societies and marketing boards have played two important financial roles in Tanzania, i.e. mobilization of small peasant savings, and acting as channels through which other credit institutions could reach the small peasant with more safety.

The cooperative movement was established legislatively in 1932, with the main motive of promoting the production and marketing of cash crops by African peasants. By 1949, there were 79 registered societies with total membership of about 60 000 (equal to about 1 % of the total population). Among these were five thrift and credit unions registered among the Asian and Ismaelite groups in 1947. The growth of the cooperative movement during 1950—64 is shown in Table 4.5.

As seen from Table 4.5, the number of registered cooperative societies rose dramatically, especially after independence—following government's emphasis on the cooperatives as a tool for rural development (see Bomani (1961)). It was after 1960 that banking, as well as thrift and credit societies got registered among the indigenous population. Thus, the number of the latter type of societies increased from 5 in 1960 to 41 in 1964.

¹⁰ For an empirical demonstration of the responsiveness of agricultural output to the credit input, see, for example, Anna Tibaijuka (1984).

Table 4.5. Growth of the Cooperative Movement During 1950—60.

	1950	1954	1957	1960	1962	1963	1964
Total Number of Registered Societies	121	243	474	691	974	1201	1358
of which:							
Banking	—	—	—	—	—	1	2
Thrift and Credit	5	5	5	...	10	19	41

Notes: — Nil. ... Not Available.

Sources: Tanganyika under United Kingdom Administration, various, Sadlier (1962), and Tanzania: Statistical Abstract 1970.

It should be borne in mind that the agricultural marketing cooperatives, apart from acting as marketing middlemen, have always acted as financial intermediaries in the rural sector.¹¹ As noted by the IBRD Tanganyika Report of 1961, the marketing cooperatives extended productive credit, albeit to a limited extent, to their members. Thus, for example, in 1959, one of the largest cooperative unions—the Victoria (later known as the Nyanza)—started experiments with the provision of fertilizer credit to its members, against repayments from the proceeds of the ensuing crop (see Rutman (1968, p. 110)). At about the same time, another of the large cooperative unions—the Bukoba native Cooperative Union (BNCU)—embarked on a general credit scheme for its members. This scheme distinguished between agricultural productivity loans, which could be paid in a period of more than a year, and emergency loans—for funerals, house reconstruction, school and medical fees—which were repayable within a year.

As far as marketing boards are concerned, it should be mentioned that in Tanzania, they were closely affiliated with the cooperative societies and lent their reserve funds mainly to the government, and the cooperatives for onward relending to farmers. The boards were first established by the African Agricultural Products (control and marketing) Ordinance of 1949.¹²

b) The Local Development Loan Fund (LDLF)

The LDLF was a revolving fund, established in 1947, to provide credit mainly to the small African farmers. Recognizing the fact that most African peasants were tied-up within the traditional land tenure system, which forbids the sale of land, and therefore had little or no security to offer, it was decided to channel

¹¹ The agricultural marketing cooperatives accounted for over 90 % of both the total number of registered societies and their membership during 1950—64.

¹² The main Marketing Boards formed in Tanzania were: the Coffee Board, the Tobacco Board, the Lint and Seed Marketing Board (dealing with cotton), and the National Agricultural Products Board (NAPB). Each of these dealt with crops that were grown by small peasant farmers.

loans by the LDLF through local government authorities. It was believed that the latter, by being closer to the farmer, could relend to individual farmers at a greater safety of recovery. However, by 1952, this arrangement had proved a failure, and the LDLF had to establish direct contacts with the farmers, granting them loans, provided that at least 50 % of the sums involved was guaranteed by the local authorities.¹³

c) The African Productivity Loan Fund (APLF)

The APLF was another revolving fund, formed by a USAID grant of EAS 2 million in 1955, with the major objective of financing the acquisition of farming and milling machines.

Both the LDLF and the APLF were managed by the so-called African Loan Funds Committee, whose primary goal was to ensure that the loans reached the indigenous peasants with limited access to other sources of credit (see Caselli (1975, p. 242)). The committee's criteria for granting loans included, among other requirements, the availability of security.¹⁴

The Experience of the Revolving Loan Funds, the LDLF and the APLF

i) Lack of Effective Demand for credit:

This may be exemplified by the degree to which the loanable funds available with the two funds were utilized/or left idle. Thus, for example, at the end of 1959, the LDLF had 252 loans outstanding, with a total value of TZS 1.1 million; while the total loans outstanding of the APLF were 308 valued at TZS 1.8 million. At the same date the total loanable funds at the disposal of each of the two funds amounted to TZS 2.0 million, implying that a total of about TZS 1.1 million, or about 27.5 % of total funds, were uncommitted (see IBRD Mission Report on Tanganyika (1961, pp. 117—118)). The main reason underlying the low demand for credit from these institutions was the insistence by the Loan Committees on *security* as a precondition for credit extension. Most African farmers had no security of the type desired. Other reasons include the failure to reach small farmers due to complexity of loan procedures and the requirement for availability of certain types of security; as well as the requirement that the borrowers themselves had to provide a deposit of at least 25 % of the total cost of the project for which the loans were being applied for.

¹³ From 1953 onwards, guarantee of loans from public authorities was required only for loans exceeding EAS 10,000—which were rare.

¹⁴ See, Report and Accounts of the LDLF and APLF for 1958, Dar es Salaam, 1959.

ii) High Rate of Default

Default in the repayment of loans is regarded as the main problem that faces agricultural credit institutions, especially those dealing with small-scale farmers (see Nyirabu (1980)). For one reason, the small farmers happen to lack high quality security to back the loans extended to them—especially where land cannot be offered as security—and for the second reason, such farmers are often subjects of natural catastrophies, which affect their capacity to repay loans.

The situation of the two funds with respect to recovery of loans, is best illustrated by the nature of the loans outstanding at the end of 1959, as presented in Table 4.6.

It is seen from Table 4.6 that the repayments on loans six or more months overdue amounted to almost 44 % of the outstanding loans in which repayment had become due for the LDLF, and to about 53 % for the APLF. The problem of loan servicing by borrowers (mainly, Africans) from the two funds is explained by the following reason: poor, and expensive in terms of the volume of loans, network for the administration of loans (see IBRD Report (1961)).

d) The Land Bank of Tanganyika

The Land Bank was established by the Government in 1947, and began its operations in 1948 with an initial capital of TZS 4 million (raised to TZS 6 million in 1950). The main objective of the bank was to provide long-term loans (15—30 years) for purchasing and clearing land, erecting buildings and other

Table 4.6. Outstanding Loans of the African Loan Funds compared with Arrears of Interest and Repayment. (Position at End of 1959) (000 TZS).

TYPE OF LOANS	Local Development Loan Fund (LDLF)	African Productivity Loan Fund (APLF)
1. TOTAL SUM OUTSTANDING ¹	581	871
of which:		
1.1 On loans on which only interest is due	358	493
1.2 On Loans on which repay- ments are due	223	378
2. INTEREST AND REPAY- MENTS 6-MONTHS OR MORE OVERDUE	101	208
2.1 Interest	3	8
2.2 Repayments	98	200

Notes: ¹ The figure here show disbursements less repayments made, while those in the text above are on basis of commitments.

Source: IBRD Mission Report on the Development of Tanganyika (1961, p. 118).

constructions related to land improvements, in amounts of up to 70 % of the value of mortgaged land and permanent improvements.

The Land Bank also provided medium- and short-term loans for the purpose of purchasing agricultural machinery, cultivation, harvesting, processing and marketing of crops.

By the nature of the security demanded by the Land Bank, only the expatriate estates could afford access to the bank's loan facilities, and to an insignificant degree, the cooperatives and the local authorities.

Sources of Funds for the Land Bank:

- i) Own funds: these were constituted by the bank's permanent capital of EAS 6 million
- ii) Commercial bank overdrafts: the capital funds of the bank proved inadequate immediately after the second year of operation, especially due to excessive lending on short-term. As a result, the bank had to rely on overdrafts from the commercial banks.
- iii) Deposits: as the gap between the supply and demand for loanable funds from the bank widened, and the costs for carrying overdrafts proved significant, the Land Bank was in 1955 authorized to accept short-term deposits from the public, in order to reduce reliance on overdrafts. The maximum amount of deposit liabilities that could be accepted by the Bank was set about TZS 14 million. By the end of 1959 the maximum limit of deposits had been reached (see IBRD Report on Development of Tanganyika (1961, p. 222)). However, in the first quarter of 1960 almost 80 % of those deposits, or some EAS 11.7 million were withdrawn, being a reflection of the capital flight following the prospects for political independence in 1960/61.
- iv) Government loans: following the withdrawals of deposits from the Land Bank during the capital flight, coupled with the limitations imposed on overdraft facilities by the fact that the commercial bank were correspondingly affected by the flight, the government was forced to support the Bank. Thus, in March 1960, the government provided a loan of EAS 2 million, which was raised to EAS 4 million in June of the same year.

Uses of Funds by the Land Bank

An analysis of the Land Bank's lending activities during 1949—60 suggests that the direction of lending became more and more short-term, especially in the second half of 1950s, as the capital flight intensified. Thus, for example, the proportion of total annual lending extended in form of short-term loans rose from an average of 32 % during 1949—55 to about 50 % during 1956—60.¹⁵

¹⁵ Short-term is defined here as a period of less than 5 years. The calculations have been made from data obtained from Tanganyika/Tanzania Statistical Abstract, 1961 and 1964.

The change towards more short-term lending by the bank may be attributed to the capital structure of the bank—in which short-term liabilities (overdrafts and short-term deposits) increased, especially after authorizing the bank to collect deposits in 1955—as well as the general increase in the demand for short-term accommodation from the bank due to the capital flight.¹⁶ The latter affected more intensively the availability of working capital (see Loxley (1979)).

It has been estimated by Caselli (1975, p. 146), that of a total sum of about EAS 60 million loaned out by the Land Bank during 1948–60, 32 % went to purchase of land and discharge of debts associated with transference of land, 28 % to annual cultivation and crop marketing, and 40 % to long-term agricultural development projects.

The main shortcomings in the operations of the Land Bank up to 1960 were more or less the same as those cited for the Loan Funds, except that the former was more successful in reaching its target clients, the plantation estates' credit needs (see IBRD Report on Tanganyika (1961)).

4.3.2 The Reorganization of the Agricultural Credit System after Independence

*i) Formation of the Agricultural Credit Agency (ACA)*¹⁷

Following the recommendations of the World Bank Mission in 1961, the agricultural credit system was reorganized immediately after independence, in order to allow for, among other things, the specialized rural financial institutions to participate more seriously in deposit mobilization. Thus, in 1961 the Agricultural Credit Agency (ACA) was formed to serve as the major specialized financial institution in agriculture. The ACA, therefore, replaced the Land Bank and the Local Development Loan Fund, and took over their assets and liabilities.¹⁸ However, part of the ACA's initial capital was subscribed by the country's large cooperative unions, and by "The Big Three", who took a minority of interest.

The ACA was charged with the duty of extending short-, medium-, and long-term (up to 25 years) credit to individual farmers, cooperative societies, local authorities, and farming companies/associations, for the purpose of improving agricultural productivity and rural development.¹⁹ In order to facilitate accessibility to small farmers, ACA's lending activities involving small sums of

¹⁶ This motivated the bank to raise its short-term lending interest above the long-term one.

¹⁷ See, Act Establishing the Agricultural Credit Agency, No. 65 of 1961.

¹⁸ See, Report of the Governing Board of the Agricultural Credit Agency for the year ending 31 December 1962, p. 17.

¹⁹ The African Productivity Loan Fund was put under the management of the Ministry of Commerce and Industry.

up to EAS 4,000 were decentralized, and handled by District Loan Committees; while loans exceeding that amount were classified as 'executive' loans and handled by the Executive Loan Committee at the ACA head-office.

Despite the relative success of the ACA in reaching small farmers, as compared with its predecessors, the default rate and the administrative costs were also relatively high.²⁰ As a result, in 1964, another reorganization of the credit system was designed with the view of reducing administrative difficulties.

ii) The National Development Credit Agency (NDCA), the National Co-operative and Development Bank (NCDB), and the National Cooperative Bank (NCB)

The reshuffle of the agricultural credit system in 1964 was based upon the belief that an administratively viable and smooth flow of funds between central credit institutions, and a large number of small farmers could best be achieved through the efficiently functioning cooperative system.

Thus, the NCDB was established as an apex institution to coordinate the activities of the NDCA and the NCB in financing the rural sector. The sources of funds for the NCDB were specified by the legislation establishing it as:

- a) Initial capital subscriptions from the cooperative movement;
- b) Allocations, in the form of contributions and dividends, from its subsidiaries, the NDCA and the NCB;
- c) Loans from the NCB.

The National Cooperative Bank (NCB) was to act as the banker to the cooperative movement; and was empowered to perform all types of credit operations, but restricted itself to crop-finance up to 1968. Its sources of funds included own capital (of about EAS 6.6 million), deposits of all kinds (amounting to about EAS 80.4 million in 1965, of which some 70 % was sight deposits), overdrafts from other commercial banks, as well as short-term borrowing from the crop financing facility of the central bank (or East African Currency Board before June 1966).

The NCB's balance sheet for the period 1964—66 is presented in Table 4.7. Deposits (especially demand deposits), grew rapidly and by 1966 accounted for over 94 % of total sources of funds of the bank, and formed about 10 % of total commercial bank deposits during 1964—66.

Table 4.7 also shows that during the first two years, the NCB had sizeable reserves (cash in hand plus balances and deposits with other banks), most of which were used up by increased short-term lending to cooperatives in 1966—a year associated with bumper crop harvests.

²⁰ Cf. Caselli (1975, pp. 247—48).

Table 4.7. The National Cooperative Bank: Balance Sheet as at March 31 (in EAS million).

LIABILITY/ASSET ITEMS	1964	1965	1966
I. LIABILITIES			
1. Deposits, Total	75.9	80.4	103.2
of which:			
1.1 Demand deposits	53.4	61.4	79.6
1.2 Time deposits	20.6	16.3	20.6
1.3 Savings	1.8	2.7	3.1
2. Other Liabilities	5.6	6.6	6.2
TOTAL LIABILITIES	81.5	87.0	109.4
II. ASSETS			
3. Cash in Hand	7.5	4.3	3.4
4. Balances and Deposits with other banks	38.0	24.3	4.1
5. Advances to Cooperatives	32.3	57.1	97.3
6. Other Assets	3.7	1.2	4.6
TOTAL ASSETS	81.5	87.0	109.4

Source: Tanzania: Statistical Abstract 1970, p. 142.

The *National Development Credit Agency (NDCA)* took over the assets and liabilities of the Agricultural Credit Agency (ACA), and of the African Productivity Loan Fund. Its functions included the granting of credit for agricultural development, processing, storage and transportation of agricultural produce, as well as for the development of agro-based small scale industries and cooperative distribution services.

To reduce administrative costs and the default rate, and at the same time reach the small peasants, it was decided that the NDCA should channel all its credit via the cooperative movement, and use the agricultural field officers of the Ministry of Agriculture to supervise its business at the district level. The sources of funds for the NDCA were:

- i) *Own-capital*: about EAS 21 million and EAS 5 million inherited from the ACA and the loan funds respectively. However, a large part of the assets inherited from the two institutions was held in doubtful debts, so that the NDCA was authorized by the government to write off EAS 11.9 million of the inherited assets.
- ii) *Deposits*: the NDCA achieved little success in mobilizing private deposits, and had to rely mostly on deposits of public institutions. Nevertheless, it was subsequently recognized, after a sharp decline in deposits by an absolute amount of about EAS 13.3 million during 1968—69, that short-term

private deposits were an inappropriate source of funds for the agency, which was supposed to lend on a medium and long-term basis.

- iii) Commercial bank overdrafts guaranteed by the government.
- iv) *Loans from the Treasury*: mainly drawings from a EAS 35 million revolving fund provided by the International Development Agency (IDA) to aid the development of agriculture in the country. By March 1969, the IDA fund had been used up to about 66 %, a large part having been allocated to the financing of agricultural inputs for cotton (27.4 % of the total amount drawn), coffee (27.8 %) and tea (19.2 %).

4.3.3 Miscellaneous Financial Intermediaries: 1950—66

In this section I discuss the contractual savings institutions—the insurance companies and social security schemes—and credit institutions for industry and housing. Most of these intermediaries evolved in Tanzania in the course of 1950—66, and did not account for a large share in the financial system (see Table 4.2). Nevertheless, the mere emergence of these institutions reflected increased specialization in finance, and to some extent financial deepening.

a) Insurance Companies

In Tanzania, modern insurance came into its own only after World War II. At the end of the war, some 30 insurance companies were operating in the country. By 1957, the number of insurance companies with offices in Tanzania had risen to 130. This number declined to 104 in 1966, following the closure of some offices during the time of the capital flight.

The impact of insurance companies on the liquidity of spending units is indicated by the relatively large amounts of funds at their disposal for investment (see Radcliffe Report, p. 241). In Tanzania, total gross premiums of the life and non-life insurance business combined, rose from about EAS 40 million in 1957 to some EAS 63 million in 1966, representing about 1 % of the nominal GDP (see Table 4.8).²¹

Of particular interest is the life business, of which premiums grew at an annual rate of about 5 % nominally during 1957—66. In real terms, this was just about equal to the average annual population growth of 2.8 % during that period.

During the period up to 1966, the insurance companies operating in Tan-

²¹ The non-life (or general) business of insurance companies includes fire, accident, marine, motor and employers' liability risks, which give rise to only short-term liabilities entailing investment of contingent reserves only. The life business, on the contrary, give rise to long-term contracts, involving accumulation of funds from life-policy holders.

Table 4.8. Tanzania: Insurance Companies — Gross Premiums. (End of December, Selected Years) (in EAS 000).

	1957	1961	1963	1966
Total Life + Non-life Gross Premiums	39786	50124	51772	62980
of which:				
Life Premiums	21634	23578	24584	31542

Sources: 1) The 1957 figures were obtained by applying the average share of Tanzania in total East African premiums during 1961–66 on the total East African premiums of that year as published in the East African Statistical Bulletin.

2) For the rest of the years, figures were obtained directly from the East African Insurance Statistics.

zania, and in East Africa as a whole, invested a large portion of their funds abroad (see Loxley (1968), Yaffey (1966)). Thus, for example, during the period 1959–64, of the total sum of the investible surpluses of insurance companies operating in East Africa (calculated as the gross premiums plus income from assets, less gross claims, management expenses and net reinsurance transfers), amounting to some EAS 480 million, only about EAS 153 million, or about 32 %, was invested in local assets.

With a view of preserving the funds that were flowing out from the country through the foreign owned insurance companies, the government took the initiative of establishing the National Insurance Corporation (NIC) in 1963 to compete with the foreign owned business. The government subscribed 51 % of NIC's capital while the rest was voluntarily subscribed by the insurance and reinsurance companies that were already operating in the country.

b) Social Security Schemes

There are no reliable records on the social security funds managed by the private sector, local government authorities and the central government prior to 1967. What is known is that employers with at least 5 employees were required by the Workmen's Compensation Act of 1949 to carry insurance cover for their employees—against old age retirement, death before retirement, as well as on partial or permanent disablement.²²

The first available figures are those of the National Provident Fund (NPF), which started operations in March 1965, as the government-owned social security institution. According to the Act establishing the NPF, contributions are to be paid both by employers and employees, and capitalized at the end of

²² Some estimates, for example Caselli (1975, p. 328), put the total assets of the central government employees compensation fund prior to formation of the NPF at about EAS 27 million, and those of local government social security schemes taken together at some EAS 200 million.

each year at a rate of 3.5 %. Benefits are payable on retirement, in case of sickness, or disablement, and on cessation of employment due to marriage, emigration or other unavoidable circumstances.

Already at the end of its first year of operation in June 1966, contributions to NPF had reached about EAS 36 million, equivalent to over 50 % of total gross premiums of all insurance companies operating in the country, and being about 4 % of total commercial bank deposits.

The NPF funds are wholly invested in government and parastatal securities.

c) Credit Institutions for the Industrial Sector: A Brief Survey

Specialized credit institutions for industry, housing and commerce were almost unknown prior to independence.²³ After independence, economic policy required specialized financial institutions through which the government could influence the flow of funds for the synchronized growth of these branches of the economy.

The Tanganyika Development Finance Company Limited, TDFL

The TDFL was formed at the end of 1962 under a joint ownership of the Tanzania government, the Commonwealth Development Corporation and the Federal Germany Republic, each of which provided EAS 10 million to its initial capital. In 1965, the Dutch Financierings Maatschappij voor Ontwikkelingsland joined the founders, raising the paid up capital of the company to EAS 40 million. The TDFL is expected to act like a development bank, of which foreign sources of funds are predominant. Thus, the share of foreign capital in total TDFL investments averaged 70 % during 1962—65, and was at 75.7 % in 1966 (see Caselli (1975, p. 277)).

The TDFL financed projects in all branches of the economy, although it gave priority to industrial ventures during 1962—66. The institution does not offer government protection.

The Tanganyika Finance Company (TAFCO)

TAFCO was established in 1963 as a private hire purchase (of motor vehicles) company. Up to 1965, it had not succeeded in mobilizing any funds for that business

In 1966, the National Development Corporation, NDC (see Chapter 7), took over the TAFCO, with a view of reconstituting it as an investment company. Later, after recognizing the problems of NDC's reliance on dividends as a major

²³ What I have in mind are credit institutions for long-term financing. In this respect, the housing sector got a specialized institution in 1956 when the First Permanent Building Society opened up business in East Africa. This will be discussed in a later paragraph.

source of funds at the time when most of its investments were in infant industries (see Binhammer (1969, p. 3)), it was decided that TAFCO should be organized to provide refinancing facilities for the NDC, and other development corporations. The authorized capital of the reconstituted TAFCO was raised to EAS 40 million, of which the NDC contributed EAS 23 million, the National Provident Fund (NPF) EAS 4 million, and the rest taken up by the National Insurance Corporation, the Bank of Tanzania and other parastatals.

At the time of reconstitution in 1966, it was expected that private firms and individuals would be the main buyers of TAFCO shares. However, following the Arusha Declaration in 1967 there was no hope for such expectations. The leadership code stipulated by the Declaration barred most of the potential clients, the ruling party and the government officials, from ownership of equity. Effectively, therefore, only the cooperative unions and the parastatals could be possible investors in the TAFCO shares.

The Mwananchi Development Corporation, MDC

This was a relatively small corporation established in 1962 by the defunct ruling party, TANU (in 1977 merged with the ASP—ruling party on the Islands to form the present ruling party, Chama Cha Mapinduzi, CCM). The MDC invested mainly in residential and non-residential buildings, but also held equity investments in commerce, fishing and construction enterprises.

The Workers Development Corporation, WDC²⁴

The WDC was formed by the National Union of Tanganyika Workers (NUTA)—the country's sole trade union, in 1964, with an initial capital of EAS 1 million. According to the country's Trade Union Ordinance, NUTA was required to put at the disposal of the WDC at least 50 % of the income received from union members' contributions; so that the paid up capital was expected to reach EAS 5 million in 1967.

During 1964–66, the WDC financed investments in beer halls, restaurants, canteens, an oil mill, a farm, a fishing factory, house building, and took about 20 % of shares in the National Small Industries Corporation (NSIC) created in 1965. The latter had an initial capital of EAS 2 million, of which the remaining 80 % of ownership was taken up by the NDC.

The Diamond Jubilee Investment Trust

The Trust was set up under the initiative of the Aga Khan in 1945, for the purpose of providing medium and short-term credit for agricultural, industrial and

²⁴ Earlier known as the Tanganyika Workers Investment Corporation.

Table 4.9. Diamond Jubilee Investment Trust (Tanzania) Limited: Savings Mobilized as of the End of June 1966.

Type of Deposit	Total Balances (EAS 000)	As % of Total Assets Outstanding (about EAS 25,951,000)
1. Fixed Deposits	4,160	16.1
2. Savings Deposits	8,723	33.6
3. EAS 100 Savings Bonds	35	0.1
4. EAS 20 Savings Bonds	27	0.1
5. Current Deposits	63	2.5
6. Sundry Deposits	2,437	9.4
Total	16,057	61.8

Source: Adapted from Binhammer (1969, p. 17).

building projects, especially to the Ismaelite community. The Trust operated on an East African basis up to 1963, when it set up independent companies in Kenya, Uganda and Tanzania.

The Diamond Jubilee Investment Trust, unlike the development corporations discussed above (the NDC, the MDC, the WDC etc.), does not offer equity investments, but mainly grants medium-term credit (3—5 years) to the private sector, working in close collaboration with its sister company, the Industrial Promotion Services (IPS).

The Trust's main sources of funds are sales of its shares, public borrowing (especially from the Ismaelite community), investment income, and above all, savings mobilized by acceptance of deposits of various types, for which it pays interest rates competitive with the bank rates and by offering savings bonds in denominations relatively attractive to the small saver. The various saving assets offered by the Diamond Jubilee Investment Trust are shown in Table 4.9.

The trust met a considerable part, close to 50 %, of its financing from time and savings deposits.

The Industrial Promotion Services, IPS

The IPS was established by the Aga Khan in 1963, with the objective of fostering industrial development in East Africa by participating in projects of local or foreign companies, by originating and managing new projects, and by assisting existing ventures.

The Tanzania-based IPS had initial capital of EAS 5 million, of which the NDC owned only 3 % of total shares, while the rest was held by the Aga Khan. However, in 1967 the capital was raised in order to allow the NDC to increase its stake to EAS 2 million, or about 28 % of the share capital. In subsequent

years, capital increases were taken up by a wide spectrum of private shareholders, mainly Ismaelites.

There are no consistent and detailed records of the uses of the IPS funds up to 1966, but it is known to have financed a number of projects in textiles, pharmaceuticals, soap and detergents.

Building Societies and Other Mortgage Credit Institutions

The first formal building society in Tanzania was the First Permanent Building Society, which extended its activities from Zambia (where it was founded in 1949) to East Africa in 1956.²⁵ This Society granted mortgage loans from its funds, which were mainly constituted by own capital and deposits from the public.

Despite the success of the First Permanent Building Society in financing the housing sector up to 1960, it ran into financial difficulties, caused by the massive withdrawals of deposits from it associated with the capital flight in early 1960s. The Society managed to survive this crisis, thanks to loans and grants from the Commonwealth Development Corporation (CDC). However, the loans needed to support its collapse were so massive that the CDC was forced to take over the control of the Society's activities in East Africa.

The CDC, on taking over the Society, reorganized it to form a housing finance institution for East Africa, under the name 'First Permanent (East Africa) Limited' in 1960.

Following the disintegration of the East African Monetary Union it was decided to replace the First Permanent (East Africa) with separate and independent national building companies. As a result, the Permanent Housing Finance Company of Tanzania was formed in 1968 to take over the activities of the First Permanent (East Africa) in Tanzania.

4.4 Concluding Observations

Having discussed the main financial intermediaries that operated in Tanzania in the post-war period, up to 1966, it is possible to show the distribution of the recorded deposits to GDP ratio across the various financial institutions that mobilized deposits in Tanzania. This is done in Table 4.10.

²⁵ Before the creation of the formal building societies, there existed ad-hoc groups of 20–30 people (especially among the Asian and the Ismaelite community), who joined themselves to finance house-building. With such groups, each member had to deposit a fixed sum in a bank at a given period interval and when a certain amount had been accumulated, the society helped to negotiate a mortgage loan for the rest of the construction costs. Houses built under this arrangement remained the property of the society until all the respective loans were repaid (see Binhammer (1969, p. 5)).

Table 4.10. Distribution of Deposits to GDP Ratio by Various Financial Institutions, Selected Years, 1950—65 (in percentages).

Intermediaries	1950	1955	1960	1965
Total Deposits to GDP Ratio	17.7	16.0	12.3	17.8
of which:				
Commercial Bank Deposits	15.9	13.9	10.7	15.8
Post Office Savings Bank	1.8	1.7	0.9	0.6
The Land Bank Deposits	--	0.4	0.7	--
ACA/NDCA Deposits	--	--	--	0.3
National Cooperative Bank	--	--	--	1.0
Diamond Jubilee + IPS Deposits	...	...	...	0.1

Notes: ... Negligible, -- Nil.

Source: As for Table 3.3.

Table 4.10 shows that the decline in the deposits to GDP ratio from 1950 up to 1960 was mainly due to the development of the deposits of commercial banks and the Post Office Savings Bank, both of which were the main deposit institutions in the country.

An important feature about the financial intermediaries that evolved in Tanzania up to 1965 is that most of them were financed either by the government or from external sources. As a result, the commercial banks and the Post Office Savings Bank (POSB) remained virtually the only deposit mobilizing institutions in the country up to 1964. In other words, there was no widening in deposit mobilizing intermediaries. This might be the reason why the total deposits to GDP ratio for Tanzania remained more or less constant in the whole period 1950—65, despite the rapid growth of specialized financial institutions.

It is also noteworthy that the POSB in effect acted as a mechanism for exporting loanable funds from Tanzania abroad, especially prior to independence in 1961. The export of finance from the country was due to the statutory requirement that the POSB should invest all its funds in British government securities. The commercial banks also channelled funds abroad during the earlier years. Still by the mid 1950's the larger part of total bank assets was held in foreign assets. The share of total assets invested abroad fell rapidly during the post war years, however.

A weakness, common to almost all the financial institutions during the period under review, was the failure to reach small-scale indigenous producers, as well as high default rate for the loans extended.

Chapter Five

Central Banking in Tanzania, 1966—80

Introductory Remarks

The period 1966—80 has been characterized as one that involved restrictions in a closed economy (see Chapter 1). Among the main features that marked the closure of the economy was the introduction of foreign exchange control in 1965, and the formation of a national monetary authority (central bank). The latter opened way to the use of monetary controls to regulate the economy.

As discussed in chapter 3, Tanzania formed its central bank—the Bank of Tanzania (BOT)—by an Ordinance (Bank of Tanzania Act) of December 1965. The BOT started its operations in June 1966.

This chapter attempts to discuss the experience of the BOT in conducting its major central bank functions, viz: issuing currency, acting as a banker to the government and financial institutions, managing foreign exchange, and conducting monetary policy during 1967—80.

An important feature characterizing the period under review, apart from the existence of a national central bank, is that all the private commercial banks were nationalized in 1967 and replaced by a state owned bank—the National Bank of Commerce (NBC)—on the Tanzania Mainland.¹ This was done after the formation of the BOT, and seem to have altered the premise in which the BOT Act was designed. Nevertheless, the BOT Act was never amended, specifically to take account of the new situation. In connection with this, one is skeptical about the capacity of the central bank to conduct some of its functions, of which the assumption of competitive banking system is particularly important.²

¹ This was a result of the Arusha Declaration. The National Cooperative Bank (NCB) was not nationalized, and it coexisted with the NBC up to 1970, when they were both merged (for more discussion, see Chapter 6).

² For example, monetary policy in the traditional context.

5.1 The Bank of Tanzania (BOT)

Legal Status of the BOT

The BOT Act of 1965 was amended in 1971 with minor modifications in the composition and conduct of meetings of the Board of Directors, annual reporting of the Bank, mode of controlling credit formation by banks, and the range of definition of external reserves of the Bank. A major amendment to the Act was that of 1978, which will be discussed later.

The BOT Act distinguishes between commercial banks and what it terms—“designated financial institutions, DFIs”. DFIs include all the non-bank financial institutions, which are ‘designated’ by the BOT as capable of enjoying its banking facilities, and thus falling under its control.

The Objectives of the Bank

According to Article 5 of the Act, the BOT is charged with all the traditional central banking functions, *inter alia*, the *promotion of exchange and credit conditions* consistent with the rapid growth of the economy, as well as domestic and external monetary stability. In the pursuit of its main objectives, the BOT is expected to engage in the *promotion of development of the main sectors of the economy*, by assisting the financial institutions dealing with the financing of the specific sectors (including the offer of refinancing facilities); direct financing of public corporations and Ujamaa Villages (production agricultural cooperatives); as well as by supervision of banks and DFIs.

5.2 The Performance by the BOT of its Main Functions

5.2.1 The Conduct of Monetary policy

As discussed in chapter 3, the main motivation towards the formation of the BOT was the desire, by the independent government to conduct its own monetary policy. Thus, Article 5 of the BOT Act sets out the main responsibility of the BOT as the conduct of monetary policy, and reads:

“Within the context of the economic policy of the government, the activities of the Bank shall be directed to the promotion of credit and exchange conditions conducive to the rapid growth of the economy of Tanzania, due regard being had to the desirability of fostering domestic and external monetary stability.”

The legislation empowers the BOT to use all the traditional instruments—including reserve and liquidity requirements, open market operations, interest rate policy—as well as selective (direct) instruments, in order to achieve

monetary policy targets.³ One may distinguish two sub-period in the conduct of monetary policy by the BOT 1966—80. The first sub-periods runs from 1966 to 1970, prior to the introduction of financial planning. During this period, the BOT operated more or less like a classical central bank, relying mainly on the traditional monetary policy tools. Despite the nationalization of the financial system in 1967, the government did not interfere directly with the operations of the system. Monetary control was, with a large degree of autonomy, pursued by the BOT.

The second sub-period in the conduct of monetary policy by the BOT runs from the introduction of financial planning in 1970—71 onwards. In this period, the discretionary conduct of monetary policy by the BOT was replaced by the financial plan, and the BOT subordinated to the government planners, as far as monetary policy is concerned.

5.2.2 Financial Planning in Tanzania as a Basis for Monetary Policy

Annual financial planning was introduced in Tanzania in 1970/71, following increased pressure on the financing of the Second Five-Year Plan (see chapter I). Annual financial planning had the main objective of mobilizing finance for the public sector and of observing the consistency between public sector investments as set in the Five-Year Plans, balance of payments and internal monetary stability.

In Tanzania, financial planning includes the following components:

- 1 The Finance and Credit Plan including:
 - i) The Government's Recurrent Budget,
 - ii) The Government's Development Budget,
 - iii) The Money Supply and Credit Allocation Plan;
- 2 The Foreign Exchange Plan; and
- 3 The Annual Development Plan.

Of great interest here is the money supply and credit allocation plan. This plan works out the desirable rate of growth of money supply.⁴ The underlying idea is that changes in currency and bank deposits, which are the monetary liabilities of the banking system to the rest of the economy, have to be balanced

³ Minimum liquidity requirements were set at 20 % of monetary liabilities of the financial institutions. Selective credit controls include sectoral ceilings on credit, selective use of interest rates, mandatory reserve requirements (such as cash margins against letters of credit) and moral suasion or window guidance.

⁴ Changes in money supply are worked out in consideration of possible increase in demand for money, mainly due to increase in nominal GPD and changes in the degree of monetization.

with changes in its monetary assets, being credit to the public and the private sectors of the economy, plus foreign exchange. In this context, foreign exchange asset holdings are an exogenous factor, worked out in detail in the Foreign Exchange Plan. Thus, given the desirable rate of growth in money supply and foreign assets, domestic credit is determined.

The volume of domestic credit determined from the above procedure is then allocated to the government and non-government users. Credits to the government are planned first, and allocations to other sectors emerge as residual. The underlying assumption is that the government had made the maximum possible efforts in matching its recurrent and capital expenditures with its normal resources i.e. taxes, non-bank borrowing, foreign grants etc., so that its overall deficit is regarded as an irreducible minimum, necessarily financed by borrowing from the banking system.

The non-government users of planned domestic credit are the parastatals and the private sector. Once the ceiling is imposed, the problem of allocating credit among the non-government sectors is easily performed by the sole commercial bank, which has the advantage of having much of the information necessary for the assessment of the credit requirements of the different sectors of the economy.

Implementation and Supervision of Financial Plans

The implementation of the financial plans is a concern of the government and the banking system as a whole. Supervision, however, rests on the BOT. In this supervisory role, the BOT relies on the information obtained from its daily summaries of banking transactions regarding the amount of government borrowing from banks and other financial institutions (versus planned), as well as the level of foreign reserves.

Shortfalls in the foreign exchange plan are usually counteracted by corrective actions from the Bank of Tanzania, and/or the government, and/or the Bank of Commerce. The Bank of Tanzania is in most cases called upon to tighten up exchange controls and import allocations, or seek accommodation from the IMF or other international organizations (plus foreign central banks). The Government may be required to seek more external assistance, while the Bank of Commerce may have to arrange more short-term accommodation from foreign banks. However, in the whole process of adjustment, by both the Government and the NBC, the central bank plays a coordinating function.

Table 5.1 shows the performance under the financial plans during 1971/72—81. The Table shows the major items of the Tanzania's financial plans, their planned levels, their actuals and deviation of actuals (realized) from plan targets. For the Foreign Exchange Plan, of which relevant figures regarding the planned levels are unavailable, I only show the magnitude of annual actual changes. High instability in the realized levels of foreign exchange reserves

Table 5.1. Tanzania (Mainland): Performance of Financial Plans, Selected Indicators (1971/72-81).
(Nominal values, in TZS millions; Fiscal Years Ending 30 June, except where otherwise specified).

INDICATORS	1971/72	1972/73	1973/74	1974/75	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81
I. FINANCE AND CREDIT PLAN										
1. Recurrent Budget Surplus/Deficit*										
i) Planned	100.0	57.0	100.0	100.0	200.0	380.0	235.0	248.5	319.2	-350.0
ii) Planned as % of Total Budget	4.2	1.8	2.5	1.6	3.3	4.9	2.4	2.0	2.3	-2.4
iii) Actual	-21.4	-36.4	482.0	-18.8	250.0	-88.3	867.1	-1199.2	-1316.4	-1250.9
% Deviation of ii) from i)	-121.4	-168.9	382.0	-118.8	25.0	-123.2	269.0	-582.6	-512.4	-257.1
2. Development Budget										
a) Total Expenditure										
i) Planned	952.2	1175.5	1642.2	2198.0	2590.0	3045.0	3860.0	5548.6	7186.4	7041.0
ii) Actual	772.8	948.7	1642.0	2225.0	2188.0	2763.6	3877.4	4756.8	4947.0	4756.5
% Deviation of ii) from i)	-18.8	-19.3	0.0	1.2	-15.5	-9.2	4.5	-14.3	-31.2	-32.4
b) External Financing										
i) Planned	557.4	544.9	681.3	1191.0	1430.0	1802.0	2227.0	3582.9	4219.0	4940
ii) Actual	385.2	540.6	681.3	1038.0	1031.0	1402.0	1368.8	1930.3	2268.0	1845.1
% Deviation of ii) from i)	-30.9	-0.8	0.0	-12.8	-27.9	-22.2	-38.5	-53.9	-46.2	-62.6
c) Domestic Bank Borrowing										
i) Planned	280.9	355.0	346.4	545.0	570.0	863.0	1138.0	1151.0	2967.4	2101.0
ii) Actual	345.6	170.4	646.2	1303.9	1422.4	202.8	1320.1	1940.4	3511.8	3009.0
% Deviation of ii) from i)	23.0	-52.0	86.5	139.2	144.5	-76.5	16.0	68.6	18.3	43.2
3. Money Supply (Broadly Defined)										
i) Planned/desired Growth Rate (in %)	15.0	12.0	10.0	8.0	10.0	14.5	20.0	20.0	20.0	18.5
ii) Actual Growth Rate (%)	10.5	19.0	16.5	25.1	29.5	18.8	13.9	38.3	31.6	26.5
Absolute Deviation of ii) from i)	-4.5	7.0	6.5	17.1	19.5	4.3	-6.1	18.3	11.6	8.0
II. NET FOREIGN RESERVE POSITION										
(% Change from December previous year)**	52.3	16.8	-63.6	-39.0	57.1	169.7	-137.2	35.2	25.5	-27.9

Notes: * Recurrent Budget Surplus/deficit is defined as the recurrent revenue (tax and other recurrent revenue) minus recurrent expenditure (current payments plus debt service charges).

** Obtained from the IMF Financial Statistics, Annual Vol. 1983.

Sources of other data: Bank of Tanzania, Report, various issues; Annual Economic Survey, various issues.

will be interpreted as a failure in the financial planning mechanism to achieve external monetary stability, unless proved to result from circumstances beyond the control of the country.

According to Table 5.1, the deviation of realized government recurrent budget surplus/deficit (accounting for less than 5 % of the total budget) from the plan targets has been very pronounced throughout the period 1971—81, ranging from +382 % in 1973/74 to —582.6 % in 1978/79. For the period, 1971—81 the average amount of deviation of the realized current budget surplus/deficit from planned was 256 %.

The deviation of actual total capital expenditure of the government from the planned amounts were less than those recorded in the surplus/deficit transferable from the current budget. Thus, the range of the deviations may be seen to have been +4.5 % in 1977/78 to —32.4 % in 1980/81, and an average (absolute-wise) deviation of about 15 % may be calculated for the whole period.

In the period under review, external financing was always (with exception of 1973/74) below the expectations of the planners. The deviations of the actual from planned amounts of finance from foreign sources reached a maximum of about —63 % in 1980/81, while the average deviation was about 30 % in absolute terms.

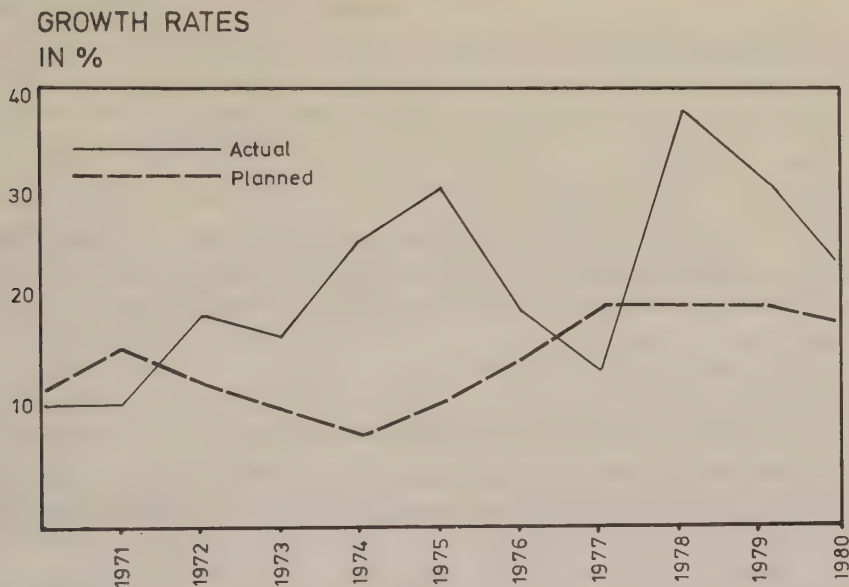
Domestic bank borrowing by the public sector was in much of the period, with exception of 1972/73 and 1976/77, well above plan expectations. The range of the deviations of the actual borrowing by the public sector from banks against planned targets was from about +150 % in 1975/76 to —76.5 % in 1976/77. The average of the deviations in absolute amounts was 67 % for the whole period under review.

Of much interest in this context, is the money supply which grew at higher rates than was planned, with exception of 1971/72 and 1977/78. Thus, the planned average rate of growth of the money supply for the period 1971—81 was about 15 %, while the realized rate was 23 %, or 53 % higher. The maximum deviation recorded, between actual and planned, was +214 % (in 1974/75). The average deviation of planned money supply growth from the actual rate for the period 1971—81 was about 82 % in absolute amount (see also chart 5.1).

The net foreign reserve position of the country as a whole appears to have been relatively unstable. Of the ten years under review, four years recorded declines in the reserve position, while six showed improvement.

Although a mass of reasons may be advanced to explain the sharp deviations of realized magnitudes from financial plan expectations (see, for example, Bank of Tanzania, Report (1978, pp. 46—51)), our concern in the above analysis is to note that the financial planning in Tanzania has not been successful as a basis of conducting monetary policy.

Chart 5.1. Tanzania: Planned and Actual Money Supply (Broadly Defined). (Growth Rates per annum).



Source: Table 5.1.

5.3 Issue of Legal Tender Currency

The BOT has the sole right of issuing legal tender notes and coins, of which the standard unit is the Tanzanian Shilling (abbreviated TZS in this study), and sub-divided into 100-cents. The par value of the TZS is determined by the President of the country, on the advice of the BOT, and in accordance with the regulations of the IMF, of which Tanzania is a member.

In pursuit of this function, the BOT has issued currency at rates shown in Table 5.2. According to that Table the ratio of the total currency issued to the money supply, narrowly defined, declined from about 48 % in 1966—69 to 35 % in 1978—81, despite the relatively high rates of growth of currency issue. The currency to M1 ratio of Tanzania, despite the fall during 1966—81, still remain much higher compared with that of the neighbouring Kenya (18 %), Zambia (18 %) or Nigeria (26 %) for the period 1978—81. The decline in the currency to M1 ratio during 1966—81 suggests that the currency to deposit ratio, and hence the income velocity of money also fell (see Chapter 8).

During the period, 1966—81, the issue of currency by the BOT rose almost

Table 5.2. BOT: Rates of Growth of Currency Issue and Changes in the Currency to M1 Ratio (Annual Averages, in percentages).

	1966-69	1970-73	1974-77	1978-81
Growth Rate of Currency Issue	14.9	19.0	19.1	28.5
Currency to M1 Ratio	47.7	38.8	32.9	35.3

Source: Bank of Tanzania: Economic and Operations Report, Various Issues.

16-fold, marking an average annual growth of about 20 %. This growth was quite high compared with the cumulative 15 % increase in the currency issue by the Currency Board for the whole period 1955—65, representing an average annual growth of less than 2 %.

5.3.1 Foreign Exchange Management by the BOT

Related with the maintenance of the exchange value of the TZS against foreign currencies, and hence with monetary policy, is the foreign exchange management by the BOT.

The need for foreign exchange reserves as a cushion against temporary balance of payments deficits is well recognized. Moreover, the pegging of a national currency at a certain parity under fixed, or managed float (or adjustable peg against a basket of currencies, and other types of pegs) exchange rate regimes, require a reasonable level of foreign reserves for intervention in periods of disequilibrium. Nevertheless, excessive holding of external reserves deprives the country of investment resources, especially where the foreign exchange gap is one of the main constraints to economic growth as might be the case for Tanzania.⁵

On the other hand, too small foreign reserves threaten the ability to stabilize the value of the currency. In order to arrive at the optimum foreign exchange reserves for a country like Tanzania, two conflicting objectives must be reconciled, viz: the maximization of growth on one hand, and external stability on the other. Indeed, right from the time of forming the Bank of Tanzania, it was recognized that the former objective will tend to predominate (Newlyn 1966,

⁵ See, for example, Speech by the Minister of State for Planning and Economic Affairs, Hon. Prof. Kighoma A. Malima, on Economic Survey for 1982/83 and the Annual Plan for 1983/84, presented to the National Assembly on 16 June 1983. The Minister explains: "Since our major problem is low level of utilization of existing capacity, increases in capital formation under this situation do not necessarily mean increases in income. This is mainly due to the lack of foreign exchange needed for the importation of raw materials, spare parts, and other important intermediate inputs". (See also Daily New, 18 June 1983).

p. 5)) and as a precaution against this, the original Bank of Tanzania Act set minimum legal limits for foreign exchange reserves. Thus, Article 53(1) of the Act stipulated:

“The Bank shall at all times use its best endeavours to maintain a reserve of external assets at an aggregate amount of *not less than the value of four month's imports* as averaged for the last three preceding years.”

The Bank is empowered to use its creativity in the choice and management of the foreign exchange portfolio (Article 53(3)), and for that purpose it was given the tool of foreign exchange control, including the regulation of import, export, and other transactions in foreign exchange. This was supplemented with import licensing, from 1971, with a view of ensuring the use of the scarce foreign exchange according to national priorities.⁶

The Bank opened its operations in 1966 with a relatively good base in foreign assets, mainly transferred from the Currency Board and from the conversion operations against the EACB currency. Thus, the Bank closed 1966 with a net official position (defined as the foreign assets of the central bank plus those of the government) of TZS 390 million, only slightly below the amount of TZS 400 million necessary to cover four months imports, as prescribed by the law.

As shown in Chart 8.2, presenting a comparison between the required and actual foreign reserves of the BOT, up to 1974, the BOT managed to maintain the level of reserves required by the Act. In the years that followed, however, the situation got out of hand. By 1978, it was already evident that the maintenance of foreign reserves equivalent to the value of four months imports was impossible, due to the sharp deterioration of the terms of trade (especially after the 1974–75 oil price increases) and the balance of payments in general (see Chapter 2).

As a result, the minimum foreign reserve requirement on the BOT was relaxed by the 1978 Amendment of its Act, and the fore-cited Article 53(1) now reads:

“The Bank shall at all times use its best endeavours to maintain a reserve of external assets at a level which is, in the opinion of the Bank, adequate for the purposes of the annual plans of the Government.”

5.3.2 Tanzania's Exchange Rate Policy

Initially, the par value of the TZS was set at 0.1214414 of fine gold, which was the same as that of the East African Shilling issued by the EACB prior to the formation of the central bank in Tanzania. The new currencies adopted in

⁶ It is beyond the scope of this paper to judge whether the introduction of import licencing was the most appropriate way of ensuring optimum use of foreign exchange, or not.

Kenya and Uganda—the Tanzania's former partners in the EACB and in the East African Community, were also given the same parity, with a view of facilitating trade among the countries. In terms of exchange rate, the TZS parity was equivalent to $\text{TZS } 7.14286 = 1 \text{ USD}$, or $\text{TZS } 20 = 1 \text{ GBP}$ (Great Britain Pound). Immediately after formation, the Bank of Tanzania continued the Currency Board's tradition of standing ready to issue TZS in exchange for sterling and vice versa, which was possible, thanks to the large foreign exchange reserves inherited from the EACB and continued moderate performance of the economy in the balance of payments field. Its buying and selling rates for the GBP were allowed to differ from parity by 3.125 % and 6.25 % respectively. In transactions with the private sector, the authorized banks were allowed to buy and sell GBPs at rates differing from parity by 0.125 % and 0.5 % respectively. In effect, the TZS was pegged to the GBP.

However, shortly after the above system started to function, the TZS was faced with the problem of the devaluation of the GBP in November 1967. It was decided that a corresponding devaluation of the TZS was not in the interest of the country.⁷

By using tight exchange controls, the Bank abstained from 'following suit' the GBP devaluation. During the same time, it was decided to shift the peg to a more stable currency, the USD, at the original parity $\text{TZS } 7.14286: 1 \text{ USD}$.

Not long after the shift, in December 1971, the dollar was also devalued, after having suspended convertibility in gold for some time, causing a serious shock to the fixed exchange rate system based on it. Following this devaluation, the TZS was at the same time devalued by 7.9 %. The dollar was further devalued by 10 % in February 1973, and the TZS followed suit. Thereafter, the adoption of floating rates in 1973 was followed by a policy of gradually shifting the peg to a basket of currencies up to 1974. This policy was reconsidered following the strengthening of the dollar, which led to re-establishment of the original TZS/USD rate. By October 1975, it was already evident that the USD was relatively stronger than other major currencies, and this was seen to have a depressing effect on Tanzania's exports. Moreover, it was felt that in the new exchange rate regime, where all major currencies floated against each other, it was less risky to peg the rate of the TZS to a basket of currencies, rather than to a single currency. Thus, in October 1975, the TZS was devalued by 15 % and its peg shifted from the USD to the SDR, at $\text{TZS } 9.66 = 1 \text{ SDR}$.

The SDR peg was maintained up to 1979, when it was shifted to a basket of

⁷ It was argued, among other things, that the devaluation of the GBP was not going to affect the country's terms of trade seriously, and that the possible increase in imports could be curbed by appropriate tariff measures; and that a corresponding devaluation was likely to be merely inflationary (see, Mtei (1968)).

currencies of Tanzania's major trading partners. This was partly because the SDR had appreciated considerably vis a vis the USD, thereby depressing the demand for Tanzania's exports. Thus, just before the shift of the peg to a currency composite (synonymously used with currency basket), in January 1979 the TZS was devalued 10 % against the SDR. The currency composition and the weights of the different currencies in the basket to which the TZS has been pegged from 1979 is unknown, but it is known that the USD occupies a relatively large weight in the bundle, although the United States accounts for a relatively small proportion of Tanzania's trade, 11 % of exports and 3.5 % of imports in 1978 (see JASPA Mission Report on Tanzania (1982, pp. 28—29)).

5.3.3 Import Licensing

Import licensing is traditionally not a central bank function. However, in Tanzania, it was made one of the tools of financial planning, and hence put under the control of the central bank.

Thus, in 1971, it was decided to relate the granting of import licenses more effectively with the availability of foreign exchange, and priority needs of the economy.⁸ The responsibility for import control, formerly under the Ministry of Commerce and industries, was therefore transferred via the Ministry of Finance to the Bank of Tanzania. Indeed, this decision was made in the light of a growing trade deficit, coupled with rapid deterioration of foreign exchange reserves.⁹

In December 1971, the Bank introduced the Open General Licence (OGL), which is a list of goods that could be imported freely without import licence. At the same time, a longer list of goods that could only be imported under specific licences, with specification of goods that were to be *confined* to certain importing parastatals and those goods which could be imported directly by other importers, was also published. Among the goods classified under the OGL were spare parts, medicines and vaccines, live animals, animal semen, seeds, fire engines, fire escapes, invalid carriages, and tug boats.

The import licensing system is complemented by the foreign exchange allocation system. Until June 1982, foreign exchange allocations were made biannually for the goods subject to specific import licences. Due to continued deterioration of the country's foreign exchange position in 1980—82, it was decided to tighten controls on the allocations and to suspend biannual issues of import licences. Instead, from July 1982 import licences were allocated, subject to availability of foreign exchange.

⁸ Prior to 1971, import licensing was primarily protectionist.

⁹ The emergence of constraints in the foreign exchange front has been analysed by Green, et al. (1980, pp. 6—18).

The severity of excess demand pressure in Tanzania in the early 1980s, may be illustrated by the level of import licence allocations relative to total applications (by value) for them.¹⁰ During the first half of 1981, the percentage of total requests approved was only 28.3 %. In the corresponding period of 1982, the percentage of approvals had fallen to mere 15.2 %. Nevertheless, the percentage of allocations to total requests differed widely depending on the category of imports. Thus, for example, during the whole of 1980—82 period, over 60 % of the applications for petroleum imports were approved, while the percentage approval for spare parts imports declined from about 9 % in the first half of 1980 to about 2 % in the first half of 1982. Similarly, the approval for requests for consumer goods' imports fell from about 25 % to 8 %; and for medicine imports from 58 % to 25 %, in the corresponding period. The picture that emerges is, therefore, one of a country forced to deprive itself of even the very essential imports.

5.4 The BOT as Banker to the Government

In its capacity as banker to the government, the Bank of Tanzania is charged with the following responsibilities (Articles 37—42 of the Act):

1. Act as the official depository of the government, accepting deposits and effecting payments for the account of the government;
2. Maintain and operate any special official accounts that the government may wish to open;
3. Manage the public debt, including issuance of debt, payment of interest on, and redemption of, bonds and other government securities;
4. Render all other types of services usually offered by banks to their customers, including short- and long-term lending; and
5. Advise the government on financial matters.

The Bank is also empowered to perform the above functions—with the exception of lending—in respect of public authorities, defined as the authorities of different administrative divisions (city, municipal, town or district councils), international organizations, inter-regional common service organizations of which Tanzania is a member, and parastatal corporations. However, in practice, the Bank has limited its activities in this field.

¹⁰ However, the sum of the requests for import licences is not a good estimate of the aggregate import needs of the economy, due to the tendency of the importers, knowing that they will get only a portion of what they have applied for, to put the estimates of their requirements on the high side. The data presented in the text are from the Bank of Tanzania.

In discussing the functions of the BOT as banker to the government, one has to consider the operations of the government vis a vis the NBC. This is because in Tanzania, the state owned commercial bank (NBC) necessarily complements the BOT in accommodating the government.

As far as taking care of government deposits is concerned, the BOT has mainly delegated that function to the NBC, especially due to the limited branch network of the central bank. The distribution of the government deposits among the Bank of Tanzania and the National Bank of Commerce during 1976—80 is shown in Table 5.3.

Table 5.3. The Distribution of Government Deposits between the BOT and NBC and Contribution of Government Deposits to Total Deposits of BOT and NBC, Annual Percentage Averages, 1967—80.

	1967-69	1970-73	1974-77	1978-80
<i>I Shares in Total Government Deposits of:</i>				
Bank of Tanzania, BOT	21.2	0.9	2.8	0.5
Bank of Commerce, NBC	78.8	99.1	97.2	99.5
<i>II Share of Government Deposits in Total Deposits of:</i>				
Bank of Tanzania, BOT	77.4	20.4	26.6	3.1
Bank of Commerce, NBC	14.8	21.0	10.6	4.7

Sources: Adapted from BOT: Economic and Operations Report, various years.

As seen from Table 5.3, from 1970 onwards, over 95 % of total government deposits have been with the Bank of Commerce, accounting for a relatively sizeable proportion of its total deposits, averaging 21 % during 1970—75. This suggests that the deposits form a potential instrument through which the liquidity of the commercial bank could be affected. However, in the late 1970s the share of government deposits in total deposits of the commercial bank had declined to merely 4 %, indicating the deterioration of the government position with the banking system. Apparently, the BOT has never used the shifting of the government deposits between itself and the commercial banks as a tool of policy.¹¹ This is partly evidenced by the more or less constant proportion of government deposits with the commercial banks.

¹¹ For a description of this technique of monetary management, see for example, Dorrance (1965, p. 277).

5.4.1 Public Debt Management: The Nature of the Government Security Market

In order to understand the problem of public debt management in Tanzania, one has to have a general picture of the government security 'market', which is different from similar markets in countries with well developed financial markets.¹²

The 'market' for government securities in Tanzania is characterized by several features of interest:

1. The owners of 'marketable' government securities are almost 98 % public institutions, including the central bank, the commercial bank and other financial institutions. The private sector holds only about 1—2 % of total government securities. As seen in Table 5.4, public institutions held over 90 % of outstanding government securities (with the exception of 1971). As far as floating debt, defined as the short-term debt of the government (with maturity of 3—12 months), is concerned (see Table 5.5), the central bank and the NBC alone held, with exception of a few years, over 80 % of it during 1966—80.
2. Neither the banks nor the other public institutions are position takers, but, for the most part, purchase the newly issued debt in accordance with the financial plan allocation (each of the potential holders is allocated a given share of government security issues in the context of financial planning), with the intention of holding it to maturity.

Table 5.4. Holders of Government Stocks and Bonds (Percentage Shares in Selected Years).*

	1967	1969	1973	1977	1980
1. Outstanding Stocks & Bonds by Value	396.1	677.1	1846.0	4491.0	10629.5
2. Held by (as % of Total value):					
2.1 Bank of Tanzania	10.5	2.1	8.3	4.7	41.2
2.2 National Bank of Commerce	3.2	21.1	25.5	41.5	18.9
2.3 National Provident Fund	28.3	28.9	28.1	24.2	15.9
2.4 National Insurance Corporation	0.5	3.0	4.2	7.7	10.5
2.5 Post Office Savings Bank	5.6	3.8	3.3	2.4	2.1
2.6 Other Public Institutions	51.3	40.6	26.4	13.3	9.4
TOTAL PUBLIC SECTOR	99.4	99.5	95.8	93.8	98.0
2.7 Private Sector	0.6	0.5	4.2	6.2	2.0

Note: * End of Year Figures, values are in millions of TZS.

Source: Adapted from the Bank of Tanzania: Economic and Operations Report, various issues.

¹² I am a bit skeptical about using the word 'market' to describe the arrangement in which government securities get acquired or disposed in Tanzania.

The yields on the securities are too low to induce potential non-public investors to hold them, given their illiquidity.¹³ The public institutions, on the other hand, are required to purchase these securities, either by considerations pertaining to their liquidity requirements (in which they are allowed to include such securities, being more attractive for them to hold than non-interest earning cash); or by the government directives embodied in the Finance and Credit Plan as mentioned above.

The foregoing discussion of the nature of the government's security 'market' boils down to the fact that there does not exist a secondary market for government securities. In this case, government short-term borrowing from the financial system—just like long-term borrowing—may not cause an immediate expansion of liquidity in the economy. Consequently, the distinction between government borrowing by means of treasury bills on one hand, and stocks and bonds on the other, becomes less important. What is crucial is probably the size of the total public debt.

Public debt management by the Bank of Tanzania has mainly been limited to issuing and allocating securities to the various public institutions, servicing them, and redeeming them at maturity. The size and composition of the Tanzania's public debt are presented in Table 5.5.

The first thing to note from Table 5.5 is that the overall size of the Tanzania's public debt rose rapidly during 1967—80, with the result that its ratio to GDP increased from about 8 % in 1967 to about 58 % in 1980. This rise was particularly marked from 1978 onwards and should mainly be attributed to increased government budget deficits (discussed in Chapter 8).

The second thing to note from Table 5.5 is the distinction between two categories of public debt—the floating debt and the national debt.

i) *The Floating Debt*, is the short-term debt of the government, represented by advances and treasury bills with maturities not exceeding 12 months. Article 39 of the Bank of Tanzania Act (1978 Amendment) imposes a maximum limit of one-sixth of the annual budgeted revenue of the government, beyond which the Bank of Tanzania cannot further accommodate the government on short-term basis.¹⁴ As a result, the government sought increasing support from the commercial bank when its borrowing from the BOT approached its limits—especially in the second half on 1970s, when the government ran large budget

¹³ Throughout the period 1967—80, the rates on government stocks and bonds have remained in the range of 6—7 1/2 % per annum, implying they were mainly negative, in real terms, during the 1970s, when inflation reached two-digits.

¹⁴ The maximum limit as percent of average ordinary revenues of the government, imposed by the original BOT ACT (1965) were direct advances maturing within 300 days = 20 %. Average annual ordinary revenue is the average of the annual recurrent revenues of the government during the *three* financial years immediately preceding the year in which the relevant calculation is made.

Table 5.5. Public Debt: Composition and Annual Changes 1967-79. (End of December positions, million T.Shs.)

	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
A. Floating Debt (Treasury Bills and Advances)														
Change (%)	69.9	136.6	197.1	279.8	407.1	382.7	419.4	817.3	1526.8	2040.8	530.0	1383.2	3063.9	5830.5
	—	95.4	44.3	42.0	45.5	-6.0	9.6	94.9	86.8	33.7	-74.0	161.0	121.5	90.3
of which held by:														
Central Bank	3.7	12.6	134.3	190.0	336.7	235.5	211.6	399.0	576.0	668.4	259.5	1019.2	1182.0	2351.6
Bank of Commerce (NBC)	30.0	104.0	41.0	—	15.0	99.0	143.0	371.0	801.0	1256.0	—	70.0	1375.0	2850.0
Total Banking System	33.7	116.6	175.3	190.0	351.7	334.5	354.6	770.0	1377.0	1924.4	259.5	1089.2	2557.0	5201.6
Proportion of the Floating debt held by the Banking System	48.2	84.9	88.9	67.9	86.4	87.4	84.5	94.2	90.2	94.3	49.0	78.7	83.5	89.2
B. National Debt	480.1	632.0	799.6	1135.4	1899.1	1884.3	2327.0	3158.0	3649.5	4540.0	5859.8	7560.7	10992.8	14918.9
Change (%)	—	31.6	26.5	42.0	67.3	-0.8	23.5	35.7	15.6	24.4	29.1	29.0	45.4	35.7
of which:														
Internal	396.1	509.0	677.6	865.4	1348.1	1532.3	1846.0	2120.0	2618.5	3138.0	4491.0	5133.5	7971.4	10629.5
External	84.0	123.0	122.0	270.0	351.0	352.0	481.0	1038.0	1031.0	1402.0	1368.8	2427.2	3021.4	4289.4
of which held by:														
Central Bank	41.6	19.3	14.5	10.2	30.1	118.2	152.5	181.1	174.1	214.5	210.2	1005.9	3151.6	4198.1
Bank of Commerce (NBC)	12.7	39.6	142.7	152.4	279.6	360.2	470.0	530.0	709.5	901.5	1862.8	1851.6	1861.6	1968.1
Total Banking System	54.3	55.9	157.2	162.6	309.7	478.4	622.5	711.1	883.6	1116.0	2073.0	2857.5	5013.2	6166.2
% of National Debt held by the Banking System	11.3	8.8	19.7	14.3	16.3	25.4	26.8	22.5	24.2	24.6	35.4	37.8	45.6	41.3
C. Total Public Debt (A + C)	550.0	768.8	996.7	1415.2	2306.2	2267.0	2746.4	3975.3	5176.3	6580.8	6389.8	8943.9	14056.7	20749.4
Change (%)	—	39.7	29.7	42.0	63.0	-1.7	21.1	44.7	30.2	27.1	-2.9	40.0	57.2	47.6
As % of GDP	8.2	10.7	13.4	17.2	26.0	22.6	23.9	28.4	30.5	31.9	24.5	29.8	42.6	58.2
% of Floating Debt in Total Public Debt	12.7	17.8	19.8	19.8	17.7	16.9	15.2	20.6	29.5	31.0	8.3	15.5	21.8	21.8

Sources: Bank of Tanzania: Economic and Operations Report, various issues; Tanzania (United Rep.): Economic Survey, various issues.

deficits. In practice, the central bank has tended to lend money to the commercial banks, for onward relending to the government, witness the coincidence of the periods when the commercial banks lent relatively large sums to the government in form of treasury bill purchases with periods when the BOT' lending to the commercial bank was at peak levels (compare Tables 5.5 and 5.7). Thus, the inflationary implications of government borrowing from the NBC are expected to have been more or less the same as borrowing from the central bank.¹⁵

A notable feature of Table 5.5 is the general tendency for the proportion of the government floating debt to increase at a relatively faster rate than the long-term debt, reflecting the emergence of large recurrent budget deficits in the second half of 1970s. As a result, by 1980, the floating debt was already accounting for about 29 % of the total debt, compared with only 13 % in 1967.

ii) *The National Debt* is defined as the long-term debt of the public sector, represented by the government bonds and stocks outstanding. This includes long-term loans to the public sector from external sources.

While the floating debt grew at an average annual rate of about 54 % nominally during 1967—80, the national debt grew at an average rate of 29 % per annum in the same period. Remembering the average annual inflation rate of about 15 % per year during 1967—80, it is evident that the national debt grew substantially in real terms, and the short-term debt even more so. The proportion of the national debt held by the banking system, defined as the central plus the commercial banks, increased considerably, from only about 11 % in 1967 to 50 % in 1980.

During the period up to 1978, the central bank was restricted to holding a maximum of government bonds and stocks equivalent to 10 % of the annual budgeted revenue (Article 40 of the BOT Act, 1965), and the tendency was for the government to rely more on the commercial bank for accommodation. As a result, the commercial bank accounted for an average of 81 % of the total outstanding long-term claims of the banking system against the public sector during 1968—78. However, immediately after the amendment of the Bank of Tanzania Act in 1978, allowing the Bank to hold government long-term securities within “the relevant limits set forth in the annual finance and credit plan” (see Article 40 of the Amendment Act, 1978), the Bank of Tanzania started to take a lion's share relative to the commercial banks. Thus, by 1979, a year just after the amendment, the Bank of Tanzania was already holding about 62 % of the total government stock outstanding with the banking system (the commercial bank plus the BOT), compared with the average of 19 % held during 1968—78. This proportion continued to rise in the years that followed.

¹⁵ For a brief discussion of this mechanism, see Aghevli and Khan (1978).

5.4.2 The BOT's Lending to the Government

It may be recalled that the Tanzania government first obtained long-term finance of EAS 20 million from the fiduciary bill arrangement of the EACB in 1957. The first issue of short-term securities (treasury bills), for the purpose of meeting short-term financial needs of the government, was made in 1960, following the Amendment of the Currency Board Regulations (see chapter 3).

The short-term security market in Tanzania developed relatively fast after the introduction of the treasury bills, as the government made an ever increasing use of them, and the Currency Board safeguarded their rates against external impulses. The latter is witnessed by the 1964 Currency Board operations, which maintained the treasury bill rate in East Africa at 4—4½ % at the time when the London market rates soared to about 7 %.

From its inauguration, the BOT continued the EACB's policy of supporting the treasury bill market by insulating it from external shocks and committing itself to rediscount the bills held by the commercial banks. Moreover, the BOT operated, during 1966—68, the so-called 'money-employed scheme', which was intended to give the commercial banks the incentive of retaining their excess balances within the country, and at the same time provide funds for investment in treasury bills. According to the scheme, commercial banks could deposit their excess cash with the BOT, and earn interest rate equivalent to that on treasury bills for the cash reserves and above the required minimum of 20 %.

The growth rates of treasury bill issues are summarized in Table 5.6.

Table 5.6 shows that with the exception of the period when the 'money-employed scheme' was operative (1966—69), the growth of the treasury bill market after the formation of the BOT up to 1977, lagged behind that of the Currency Board period (1961—65). This may be attributed to the stricter (than the EACB's treasury bill allocations) limits imposed by the BOT Act on the Bank's holdings of treasury bills. According to the 1965 version of the Act, the BOT could hold a maximum amount of treasury bills equivalent to 20 % of the annual budgeted (recurrent) revenue of the government (and 25 % when other long-term public sector securities were included). This fixed proportion implied relatively slow growth in the acquisition of treasury bills by the BOT

Table 5.6. Average Annual Growth Rates of Treasury Bill Issues (Nominal) (Percentages).

	1961-65	1966-69	1970-73	1974-77	1978-81
Growth Rate of Treasury Bill Issues per Annum	36.7	49.1	22.8	35.4	90.6

Source: Adapted from Table 5.5. Data for 1961—65 were collected from the Bank of Tanzania.

Table 5.7. BOT Actual Lending versus Statutory Limits (S.L.), 1966—1980
(end of Year Figures, values in millions of TZS).

Year	Estimated Government Budgeted Revenue (GBR) (S.L.)	Outstanding Advances as % of GBR S.L. = 20%)	Outstanding Treasury bills + Short term Securities (S.L. = 25%)	Outstanding Long-term Securities as % of GBR (S.L. = 10%)
1966	974.8	—	8.6	4.9
1967	1100.5	1.7	4.1	3.8
1968	1250.9	—	2.6	1.5
1969	1576.9	—	9.4	0.9
1970	1683.0	12.8	11.9	0.6
1971	1859.2	14.7	19.7	1.6
1972	2294.9	8.8	15.4	5.2
1973	3002.4	4.5	12.1	5.1
1974	3942.3	12.2	14.7	4.6
1975	4062.0	15.2	18.5	4.3
1976	4933.7	14.7	17.9	4.3
1977	6629.3	12.7	7.1	3.2
1978	6441.1	14.1	31.4	15.6
1979	7679.6	10.0	56.4	41.0
1980	8511.4	13.5	65.7	51.5

Notes: ** Figures in this column do not include advances.

* The governments's annual budgeted revenue is equated to the government's recurrent revenue.
S.L. Stands for statutory limit.

Source: Adapted from Bank of Tanzania, Report, various issues.

in the period when the government budget was growing modestly (see chapter 8).

Nevertheless, after the amendment of the BOT Act in 1978 to lift the limits on both short- and long-term lending to the public sector by the BOT, the growth rate of treasury bill issues took a very rapid pace compared with the preceding period.

However, it is important to note that the BOT managed to observe its legal limits, as far as lending to the government was concerned, up to 1978, when the situation called for their review. This is illustrated in Table 5.7.

The striking feature from Table 5.7 is that one was not even close to the statutory limits for advances and bonds before 1978, despite the heavy pressure imposed by huge government budget deficits in the second half of the 1970s. As argued above, during the period, the tendency was for the commercial bank to accommodate the government at times when the central bank approached its lending limits to the government. As seen from Tables 5.7 and 5.5, the years when the ratios of the various groups of government paper, by nominal value

Table 5.8(a). Proportion of Floating Debt held by the Banking System and its Distribution between the BOT and the NBC (in %).

	1967-69	1970-73	1974-77	1978-80
Proportion of Floating Debt held by Banking System	74.1	81.6	82.0	83.8
of which:				
BOT	27.5	65.7	42.1	50.9
NBC	46.6	15.9	39.9	32.9

Source: Adapted from Table 5.5.

to the government annual budgeted revenue were relatively high, coincide with those when commercial bank holdings of the corresponding groups of securities were at peaks. The years 1971 and 1974—76 are the case in point. This is also evidenced by Table 5.8(a), which suggests that during the 1970s, the proportion of the floating debt that was held by the banking system in Tanzania remained more or less the same, and that it was only the distribution of this debt between the central bank and the commercial bank which changed.

It should be cautioned that the policy of shifting the accommodation of the government from the central bank to the commercial bank may be said to be only a matter of 'book-keeping', and should not be expected to produce any monetary effects.

Immediately after the relaxation of the limits that followed the amendment of the Act in 1978, the previously existing limits were overshot. Thus, as seen from Table 5.7, the 25 % limit on the holdings of short-term paper (including advances, treasury bills and securities maturing within 12 months) was overshot to about 31 % in 1978 (i.e. immediately after the lifting of the limit on the amounts of securities maturing within 12 months), and to 66 % in 1980. Similarly, the lifting of the 10 % maximum limit on the holdings of long-term securities permitted the Bank of Tanzania to acquire more government debt, with the result that the corresponding ratio rose to 15.6 % in 1978 and gradually reached about 52 % in 1980.

The effect of relaxing the lending limits to the government by the amendment of the BOT Act in 1978 is also reflected in the rapid increase of the ratio of BOT government lending to GDP, from less than 2 % in any of the years prior to 1978 to about 4 % in 1980 (see Table 5.8(b)).

The trends in public debt—discussed above—explain why one should expect a higher rate of monetary expansion in the period after 1978, in which the central bank has had very few legal limits vis a vis its activities with the central government. The 1978 amendment of the Act relaxed the government borrowing restrictions from the Bank, with the result that the central bank has been turned

Table 5.8(b). BOT lending to the Government as ratio of GDP (Selected Years, values in million TZS, ratio as %).

	1968	1971	1974	1976	1980
1. Short-term lending by Treasury bills + advances	8.9	146.7	187.4	92.4	421.7
2. Long-term lending by issue of stocks and bonds	-22.3	19.9	28.6	40.4	1085.7
3. Total lending	-13.4	166.6	216.0	132.8	1507.4
4. Total lending as % of GDP	-0.2	1.9	1.5	0.6	4.2

Sources: Lending figures are from Table 5.5, while GDP figures are from National Accounts of Tanzania, various issues.

to accommodate the government subject to the discretion of the planners. The effect has been for the central bank to lose its autonomy with respect to the government.

5.5 Banker to banks

In line with the traditional principles of central banking, Article 43 of the Bank of Tanzania Act provides that the Bank: “may generally act as banker to banks and designated financial institutions”, and in that capacity may:

- a) open accounts, accept deposits and collect money and other monetary claims for and on account of the respective financial institutions;
- b) provide additional services such as those of a clearing house, as well as the provision of credit facilities and safe deposit facilities.

The Bank of Tanzania is legally restricted from direct participation in business transactions with domestic non-financial institutions and individuals. This restriction has been based on the traditional argument that the central bank cannot control the commercial banks (and other financial institutions), and at the same time compete with them.¹⁶

The Bank of Tanzania began its relations with the commercial banks by opening accounts for them in its books to facilitate the currency conversion (from the EACB currency to new Bank of Tanzania currency) operations. The same accounts were used in inter-bank clearings, previously handled by the EACB and the expatriate banks' head offices in Nairobi and London. However, fol-

¹⁶ For more discussion of this argument see Sayers (1957, p. 118).

lowing the nationalization of the banks, and the formation of the NBC in 1967, the interbank clearings were internalized. As a result, the commercial banks' deposits under these accounts for clearing purposes declined, especially during 1968—72.

Although according to the Act (Article 47), the Bank “may from time to time, require all banks to maintain minimum cash balances on deposit with the Bank as reserves against the deposits and other liabilities”, in practice it has never imposed reserve requirements of such kind, but has preferred to apply more direct means and moral suasion for the purpose of controlling the operations of the commercial bank.

The general interpretation of Table 5.9, presenting the net position of the commercial bank versus the BOT,¹⁷ is that, during the period 1966—80, the central bank's net claims on the commercial banks experienced declines for most of the period, with the exception of 1970—71, 1974—75, 1978 and 1980, when there were sharp increases in the Bank of Tanzania's lending to banks.

The decline in the commercial bank's need for the Bank of Tanzania's accommodation must be seen as a reflection of the increase in the public sector liabilities to become a major component in the portfolio of the banking system (see also chapter 6). To the extent that the public sector securities are liable for rediscounting by the central bank, the NBC could always rely on rediscounting rather than borrowing from the Bank of Tanzania. In practice, however, the use of the Finance and Credit Plan to allocate credit formation by the central and commercial banks has limited the possibilities, whereby the NBC is forced to resort to the central bank for accommodation. There was the case in which the Bank of Tanzania technically lent to the NBC—in the years when its lending limits to the public sector were approached—with a view of boosting up its lending capacity to the public sector.

The Bank of Tanzania's activities as last resort lender to the commercial bank and other financial institutions (the DFIs) are regulated under Article 44 of the Bank's Act. However, it should be noted that the idea of last resort lending has to be reconsidered in the Tanzanian situation. Last resort lending by a central bank is applied in a situation where privately competing banks cannot borrow from each other because all of them are in need for cash—due to a run on the entire banking system. In Tanzania there is only one bank and a run on the “banking system” for cash is rather inconceivable, so that the whole idea of last resort lending becomes meaningless.

The BOT has the discretion of regulating the terms at which it refinances the banking system, and may charge different rates for bills it rediscounts, depend-

¹⁷ Net position or net lending of the commercial bank versus the BOT is defined as the BOT's lending to banks less the deposits/reserves of the banks with the BOT.

Table 5.9. BOT: Net Lending to Commercial Banks and its Annual Growth Rates, 1966—80 (Values in TZS million).

Year	Net Position (2—1) 3	Annual % change in Net Position 4
1966	57.7	- - -
1967	52.0	-9.9
1968	33.0	-36.5
1969	32.4	-1.8
1970	68.0	109.9
1971	160.3	135.7
1972	133.3	-16.8
1973	-13.1	-109.9
1974	890.1	903.2
1975	991.2	11.4
1976	718.3	-27.5
1977	340.7	-52.7
1978	829.6	143.5
1979	124.0	-85.1
1980	250.7	102.2

Note: - - - stands for Nil.

Source: Bank of Tanzania, Report, various issues.

ing on the purposes for which they were issued. However, bills of exchange, promissory notes, and other securities rediscounted by the central bank must, according to the legislation, satisfy two conditions, viz:

- a) bear the endorsement or acceptance of a bank of DFI, and mature within 180 days from the date of acquisition, except in case where such instruments were issued for the purpose of financing agricultural or industrial production; and
- b) have been issued for the purpose of financing commercial, storage and production activities within the country.

Apart from this rediscounting facility, the Bank may extend loans and advances on discretionary terms to the banks and DFIs, provided that such direct loans mature within at most six months, exception being made again with respect to those granted for refinancing agricultural and industrial production, whose maturity may extend up to one year.

The rediscount rates and rates of interest charged by the central bank for rediscounting debt instruments and granting loans and advances to banks, DFIs, and to the government are shown in Table 5.10(a).

According to Table 5.10(a), in the period when inflation was accelerating fast, the cost of funds from the central bank to the other financial institutions (including banks) remained more or less unchanged. Thus, the cost of funds

Table 5.10(a). BOT: Nominal Rediscount and Advances Rates, 1967—81
(End of year rates)**.

Year	COMMERCIAL BILLS CROP BILLS		OTHER BILLS*		TREASURY BILLS*** REDISCOUNTS ADVAN- CES	
	90-days	91-180 days	90-days	91-180 days		
1966		5.00			4.88	5.38
1967					4.36	4.86
1968					4.57	5.07
1969						
1970			5.25	5.25		
1971	5.00	5.50				
1972						
1973						
1974					4.27	4.77
1975				5.25		
1976			5.75	5.75		
1977				5.75		
1978						
1979	6.00		7.00	7.50		
1980						

Notes: * For other commercial bills the rates indicated for 1966—77 are the minimum ones, with the maximum ones being about 1.00—1.25 percentage points higher. However, after 1977, the rediscounting rates for the non-crop commercial bills have been made uniform, so that there has been only one rate.

** The rates are usually uniform throughout the year, as they are fixed.

*** The rates are for treasury bills of 35-days maturity. Treasury Bills of all maturities rediscount at a 1/2 % and advances at 1 % above the current rate for bills.

Source: Bank of Tanzania, Report, various issues.

for crop financing purposes from the Bank of Tanzania changed only twice; while that of other commercial bills of up to 90-days maturity changed three times. The cost of rediscounting bills with 91—180-days maturity of non-crop type was slightly lowered in 1975, and then readjusted to the level it had maintained from 1967—74.

The treasury bill rate and advances rate of the Bank of Tanzania remained unchanged for the whole period 1970—80.

The effect of inflation on the ordained nominal rates has been to produce a negative schedule of real interest rates from 1971/72 onwards (Table 5.10(b)). Apart from the fact that the central bank has subsidized the cost of capital by charging low rates of rediscounting and advancing, the unchanging character of the 'central' rates suggests that the Bank of Tanzania has not utilized interest rates as an instrument of monetary policy during the period 1967—80. The only

Table 5.10(b). Bank of Tanzania: Real Rediscount and Advance Rates, 1967—1981. (Rates are in percentages).

Year	Commercial Bills				Treasury Bills		
	Inflation rate (p)	Crop Bills 90-days	Other Bills 91-180 days	Other Bills 90-days	91-180 days	Rediscounts	Advances
1967	2.2	2.7	3.2	3.0	3.5	2.1	2.6
1968	4.4	0.6	1.1	0.8	1.3	0.2	0.6
1969	2.1	2.8	3.3	3.1	3.6	2.1	2.6
1970	3.1	1.8	2.3	2.1	2.6	1.1	1.6
1971	5.0	0.0	0.5	0.2	0.7	-0.7	-0.2
1972	7.6	-2.4	-2.0	-2.2	-1.7	-3.1	-2.6
1973	10.6	-5.4	-5.0	-5.2	-4.7	-6.1	-5.6
1974	18.4	-11.3	-10.9	-11.1	-10.7	-11.9	-11.5
1975	27.0	-17.3	-16.9	-16.7	-17.1	-17.9	-17.5
1976	6.9	-1.9	-1.4	-1.2	-1.2	-2.6	-2.1
1977	11.4	-5.7	-5.3	-5.1	-5.1	-6.4	-6.0
1978	11.2	-4.7	—	-3.8	-3.3	-6.2	-5.8
1979	13.7	-6.8	—	-5.9	-5.5	-8.3	-7.9
1980	30.4	-18.7	—	-17.9	-17.6	-20.0	-19.7
1981	25.7	-15.7	—	-14.9	-14.5	-17.0	-16.7

Source: Based on the nominal rates shown in Table 5.10(a). Inflation rate has been approximated by changes in the NCPI. The formula used to deflate the nominal to real rates (r) is:

$r = (i - p) / (1 + p)$, where, i = the nominal rate for current year t , and p = inflation rate.

policy that was implemented in this field was the maintenance of the penal rates at one-half percent and one percent for rediscounts and advances respectively above the current treasury bill rate for the whole period, with a view of preventing persistent recourse of the sale of treasury bills as a main source of raising short-term funds.

Concluding Observations

In the foregoing sections of this chapter, the functions of the Bank of Tanzania as a central bank have been discussed. The sources and uses of funds by the BOT have been left to be described in Chapter 8, after discussing the non-central bank institutions during 1967—80. This is because of the belief that the central bank's assets and liabilities—which give a sort of an aggregate view of the developments in the financial system as a whole—may best be understood with the background of the other financial institutions.

In discussing the pursuit of central bank functions by the BOT during 1967—80, several important observations are worth recapitulating. First, it has been observed that in Tanzania, the distinction between the BOT and the NBC, especially as far as their relations with the government are concerned, is doubt-

ful. In actual fact, the NBC has more or less acted like an 'arm' for the BOT to perform its function as banker to the government.

The second main observation from this chapter is that financial planning as a basis for conducting monetary policy in Tanzania failed during 1970—80. This was mainly due to the absence of mechanisms to ensure adherence to the financial plan targets.

Finally, the chapter has noted that due to ceilings on nominal rates of interest at the time when inflation was relatively high, the BOT operated with a schedule of negative real interest rates from the early 1970s onwards. The implication is that the central bank subsidized the other financial institutions with access to its rediscounting facilities, and the government.

Granted the above observations, it may be concluded that operations of the BOT, as a monetary authority of Tanzania during 1967—80, and especially after 1970, might have hampered the efficient deployment and allocation of financial resources in the country.

Chapter Six

Commercial Banking after the Arusha Declaration, 1966—80

Introductory Remarks

As mentioned in chapter 5, following the Arusha Declaration of February 1967, all commercial banks in Tanzania, with the exception of the National Cooperative Bank (NCB) and the Peoples Bank of Zanzibar (PBZ), were nationalized and their assets and liabilities vested in a new and wholly-government-owned National Bank of Commerce (NBC).¹

The nationalization of the banking system was considered a logical step in the efforts of the government to control the use of financial resources. The main intention was not to control the behaviour of the banking system, which could be done without nationalization, but to achieve cooperation of these institutions in the implementation of the policies propounded in the Arusha Declaration (cf. *Annals of the NBC* (1967, p. 23)). Moreover, it was hoped that a nationalized banking system, by applying social rather than private profitability criteria, would transcend the limitations of the expatriate banks and attain:²

- a) rapid extension of banking facilities throughout the country;
- b) a fairer remuneration of deposits; and hence, with (a) above, an accelerated rate of savings mobilization;
- c) efficient distribution of the savings mobilized through the banking system according to national priorities;
- d) modest profits for the government.

The capacity of a monopoly bank to reach these expectations depends largely on its legal standing and the type of control exerted over it by the monetary authorities (the central bank and the treasury). In this section I attempt to analyse the performance of the National Bank of Commerce, which has been the sole commercial bank of the Tanzania Mainland from 1970, both in relation to the high expectations, and to the performance of the expatriate banks before nationalization.

¹ The Cooperative Bank (NCB) was accounting for a relatively small part of the banking business in Tanzania (about 6—8 %) at the time of nationalization, while the PBZ was confined to Zanzibar; so that the NBC could be regarded to represent a fair picture of the commercial banking scene of the Mainland.

² See, *The NBC Story* (1971, p. 8).

6.1 The National Bank of Commerce (NBC): Legal Status

The legal competence of the NBC rests on the National Bank of Commerce (Establishment and Vesting of Assets and Liabilities) Act of February 1967 (Amended in June 1967). According to the Act, the main objective of the NBC was to provide adequate and proper banking services throughout the country. For this purpose, it is empowered to conduct all types of "normal" banking business.

In fulfilment of its functions, it is expected that the NBC will run its business "on strict commercial principles and the credit worthiness of borrowers will be the most important criterion in the Bank's lending policy, together with other relevant requirements".³ Political pressure was not to be applied in order to meet credit requirements of any particular group of borrowers (see section 4(b) of the Act).⁴

Nevertheless, the management of the NBC is greatly influenced by the Treasury, the Minister of which is responsible for the appointments to the main positions in the Board of Directors and for the broad policy guidelines in functioning of the bank. Moreover, the NBC is subject to the control of the BOT, which in the context of monetary policy may impose upon it reserve and liquidity requirements, determine the interest rate structure, and apply controls of a selective nature (cf. chapter 5).⁵

6.2 The Performance of the NBC During 1967—80/81: General Characteristics

The development of the NBC can so far be said to have gone through two phases: the first phase involved the transformation of the bank "from an ill-assorted collection of separate banks struggling to continue normal banking operations into an efficient unified organization with a strong and competent Head office, and with managers of proved ability at the branch level" (NBC,

³ See, Address by the Minister for Finance to the National Assembly when introducing a Bill to Establish the NBC, 14 February 1967.

⁴ In this connection, the Minister for Finance in introducing the Bill for the NBC Act to the National Assembly noted that "it is absolutely necessary that the profitability of the Corporation (NBC) is maintained." (Ibid.)

⁵ It may be recalled, from Chapter 5, that the use of the traditional tools of monetary policy in Tanzania has been replaced by financial planning.

Annual Report (1968, p. 8)). The second phase in the growth of the NBC may be dated from 1970 onwards, and related to the expansion of banking business under conditions totally different from those of the preceding period and probably requiring the use of new principles of banking management.

The characteristics of the first phase

During the first phase of the NBC's development, the predominant client of the bank remained the private sector, which continued to account for over 50 % of the total bank credit. The public sector was still relatively small, although expanding rapidly through the post-Arusha nationalizations (see chapter 2), and the central government was managing its financing requirement without much recourse to commercial bank borrowing. The foreign exchange position of the country was relatively strong—thanks to good export performance over the period (see chapter 2), and large foreign reserves inherited by the BOT from EACB. As a result, rationing of foreign exchange was not a constraining factor to credit demand.⁶

The first phase was also characterized by capital flight, associated with the post-1967 nationalizations, and made easy by the fact that the EACB currency was at that time being converted into national currencies in all the East African countries (see chapter 3).

With the exception of the housing sector, where the Permanent Housing Corporation started to offer specialized finance from 1968, and the agricultural sector, where the National Cooperative and Development Bank (and its affiliates) was active from 1964, there existed no specialized financial institutions for the other sectors of the economy.⁷ As a result, the NBC was approached with many and varied demands for medium- and long-term credit. However, the NBC faced some competition from the National Cooperative Bank (NCB), which was closed down in 1970.

Another important feature of the development phase of the NBC, ending in 1970, was the prevalence of positive real interest rates. The interest rates set by the BOT immediately after formation were based on those prevailing during the Currency Board period, when inflation was relatively low (see chapter 2). During 1967–70, inflation rates remained low, with the result that the nominal rates were not so much eroded. Thus, although the real rates of interest declined over this period, they generally remained positive (see, for example, Table 6.3(b)).

⁶ In a country which is largely dependent on imports of investment goods, availability of foreign exchange may strongly affect the demand for credit. For the Tanzanian case, see, for example Green (1982).

⁷ Following the nationalization of the main financial institutions in 1967, most of the specialized institutions that had evolved in the prior period became more or less dormant.

In the light of the above characteristics, one may say that during 1967—70 the NBC operated more or less like a normal commercial bank, trying to maximize its profits, consolidate its position and increase public confidence in it. There was little government control over its deposit and loan activities and the central bank stood ready to assist the bank, whenever it needed extra cash or advice, without imposing severe restrictions on its operations (see, BOT Reports for the period 1968—70).

Main characteristics of the NBC's second phase of development

Two basic features may be said to have characterized the second phase of the NBC's development (1971—80). The first of these is related with the rapid expansion of the public sector after 1967, which by 1970 had started to raise the concern about the sources of financing the ever increasing public sector financial requirement (see chapter 8). Moreover, by 1970, the public enterprise sector (parastatals) alone—excluding the central government, regional government authorities etc.—had crowded-out the private sector as the major borrower from the NBC. The emergence of public sector budget deficits in early 1970s caused an increased need for the government to borrow from the NBC. These characteristics motivated the introduction of annual financial planning in 1970 (see chapter 5).

The second characteristic of the period after 1970 is that the NBC had complete monopoly in the sphere of commercial banking in the Mainland part of Tanzania. Further, after the creation of specialized credit institutions for the major sectors of the economy during 1970—73, the NBC specialized in short-term credit.

Following the adoption of financial planning in 1970, there emerged a type of interaction between the BOT and the treasury on one hand, and the NBC on the other, which ruled out the possibility for the latter to intermediate efficiently. The BOT and the treasury impose constraints on both deposit mobilization and lending by the NBC. On the deposit side, these constraints include regulated (fixed) interest rates, as well as reserve and liquidity requirements. On the lending activities, the constraints imposed are the fixed and differentiated (by sectors and type of ownership) loan rates, ceilings on total lending, and allocation of total credit among the major institutional borrowers (government, parastatals, private sector).

The constraints on deposit activities have incapacitated the NBC to offer attractive rates on deposits, which might have deterred savings mobilization by the bank.

As for the lending activities, the restrictions imposed on the volume and on the loan interest rates seem to limit the possibilities for the NBC to operate in a profit maximizing manner.

6.2.1 The Performance of the NBC During 1967—80/81: Main Indicators

One of the main policies that could have affected the performance of the NBC during 1967—80 is that of fixing, by the BOT, of real interest rates on deposits and loans at low positive or negative levels (see Table 6.3(b)). In doing this, the BOT has assumed that African savers—mostly small savers—are more responsive to improvements in banking services, associated with a wider spread of the financial network, financial advice and education in modern banking habits, than to yields on deposits (see Nyirabu (1980)). In pursuit of this policy, the NBC's efforts towards deposit mobilization were concentrated on the expansion of its branch network.

Penetration and Branch Formation

In this section, I distinguish between bank branch offices and bank agencies. The former are defined as banking units with at least a manager and a working staff of four. The latter are banking units with a working staff of less than four, and performing only deposit collection and some limited financial services, excluding direct lending. I also distinguish between penetration, i.e. the extension of bank services to remote areas, and the sheer increase in the number of banking offices in areas already serviced by banks.

In the first phase of its development, the NBC was concerned, above all, with the rationalization of the branches of the nationalized banks, which were—concentrated in major towns and competed with each other for business.

Thus, for example, of the total of 64 bank offices in the country in 1966, 13 were in Dar es Salaam, 7 in Tanga, 6 in Moshi, 5 in each of Mtwara, Mwanza and Arusha, and 4 in Bukoba. This is to say that 70 % of all banking offices was concentrated in 7 towns. The rationalization of the NBC's network, involving the closure of some branches in various towns or their replacement with agencies, and the opening of branches or agencies in towns formerly not served by banking units, was motivated by at least three reasons: the shortage of experts (coupled with the need to retain a large number of those who were available at the NBC's head office, unnecessary competition arising from having too many branches in one town and the related economies of scale, as well as the general policy commitment to have at least an agency in every district—as a first step towards penetrating remote areas.

In connection with the rationalization of branches policy, it was immediately decided to close down some of the nationalized branches in Dar es Salaam, Tanga, Moshi, Mtwara, Mwanza, Mbeya, Morogoro, Iringa, Tabora and Bukoba—all of which had more than two branch offices at the time of nationalization. At the same time, it was decided to open new branches in some district and sub-district towns that had formerly no banking office or agency. These included Sumbawanga, Korogwe, Lushoto, Ifakara, Makambaku, Mbozi, Kyela, Tarime, Same, Babati, Masasi, Nzega, Maswa, Ngudu and Nansio. In choosing the district towns in which branch offices/agencies were to be established, the number of savers was the criterion.

Table 6.1. Commercial Bank Branch Offices and Agencies, 1966—80 (Selected Years).

	1966	1969	1974	1977	1980
1. No. of Branches	64	37	59	93	104
2. No. of agencies plus Mobile Units	4	93	164	319	213
3. Total (1 + 2)	68	130	223	412	317
4. Average Population per branch office (in ,000)	181	346	253	188	173
5. Average Population per banking unit (pop.E 3) in ,000	171	98	67	42	57

Sources: 1) Tanzania: Statistical Abstract, various issues (population figures were also obtained from this source);

2) National Bank of Commerce: Kujenga Ujamaa Vijijini (1974);

3) Nyirabu, C.M., Banking Policies and Priorities in Tanzania in the 1980s, in Bank of Tanzania: Economic and Operations Report, 1980.

The effect of the NBC branch rationalization policy is seen in Table 6.1. The number of branch offices was reduced to 37 in 1969 from 64 in 1966, before nationalization. At the same time, the number of agencies increased sharply to 93 in 1969 from 4 in 1966. However, as the administrative capacity of the NBC improved, the number of bank branch offices and agencies rose gradually to 93 and 319, respectively, in 1977. As the bank branch offices grew further to 104 in 1980, agencies were decreased to 213. This shows the tendency to offer more complete banking services by opening up branch offices, and closing down the agencies.

As for the penetration—geographical spread of banking facilities—by 1973/74 the NBC had already established offices in all the 65 districts of the country, except for 18, which still had only agencies (cf. NBC Report, Kujenga Ujamaa Vijijini (1974, p. 5)). By 1977, only 9 districts remained without branch offices (see Nyirabu (1980, p. 49)), and by 1980 all districts had got at least one banking office.

Among the factors accounting for the great increase in the number of banking agencies after 1966 were two savings mobilization schemes, viz: the practice of the NBC personnel to collect savings directly at the industrial sites on pay days, and the practice of having agents in large farms and industrial plants.

When agencies and bank offices are combined, the commercial bank network appears to have been considerably enlarged during the post-Arusha period. The average population served by a commercial banking unit decreased from about 171,000 in 1966 to 42,000 in 1980.

In order to trace the effects of this penetration, and expansion, I turn to an analysis of the developments in the NBC's assets and liabilities.

6.3 The Sources and Uses of NBC Funds: General Comments

Tables 6.2(a) and 6.2(b) present the sources (liabilities) and uses (assets) of the NBC funds during 1967—81 in values and in percentages respectively. It is evident from both Tables that during the period, deposits formed the major source of funds of the bank, accounting for an average of about 80 % of the total sources of funds. Of the total deposits, demand deposits alone accounted for about 50 % of the total sources of funds, while time plus saving deposits contributed an average of about 30 % of funds during 1967—81. Other sources of funds for the NBC, lumped under the item “Other liabilities” in Table 6.2(a) and 6.2(b), include mainly capital and reserves. An important trend to be noted in the composition of the sources of NBC funds during the period was the marked rise in the contribution of time deposits, coupled with decline in the contribution of demand deposits during 1967—73. This will be discussed in detail below.

As far as uses of NBC funds are concerned, Tables 6.2(a) and 6.2(b) suggest that during 1967—81, the main uses of funds by the bank were lending to non-government domestic sectors and, especially after 1973, lending to the government. The former accounted for an average of about 53 % of the total uses of funds during the period, while the latter took a share in total uses that increased from mere 3.3 % in 1967 to 35.1 % in 1981. Other uses of funds by the NBC included balances and deposits with other banks (mainly the central bank), as well as other assets, mainly fixed capital, the shares in total uses of which declined during the period.

The following sections of this chapter are devoted to a more thorough discussion of the developments in the sources and uses of funds by the NBC during 1967—81.

6.3.1 Performance of the NBC in Deposit Mobilization

As mentioned earlier in this chapter, the main factor that might have influenced deposit mobilization by the financial institutions in Tanzania during 1967—80 is the BOT's assumption that small African savers are more responsive to improvements in banking facilities than to yields on financial assets. In this sections I attempt to assess the performance of the NBC in mobilization of domestic deposits, with reference to this assumption.

For the foregoing purpose, I shall distinguish between interest earning deposits, i.e. time and savings deposits, on one hand, and the non-interest earning deposits, i.e. demand deposits, on the other. The latter type of deposits are held for the advantage they offer in the settlement of bills, as well as the opportunity for easy access to overdraft credit.

Table 6.2(a). The National Bank of Commerce (NBC): Balance Sheet as at end of Selected Years. Figures in TZS Million.

Liability/Asset Items	1967	1969	1971	1973	1975	1977	1979	1981
I. Liabilities (Sources of Funds)								
1. Deposits, Total of which:	1033.1	1595.6	2202.9	3019.6	4530.8	6500.4	10523.4	14985.9
1.1 Demand Deposits	680.4	931.8	1192.1	1662.0	2872.2	4309.4	6932.5	9348.0
1.2 Time Deposits	206.0	479.8	779.4	1008.5	1158.9	1376.5	2446.6	4003.7
1.3 Savings Deposits ¹	146.7	184.0	231.3	349.1	499.7	814.5	1144.3	1634.2
2. Other liabilities, Total	264.6	361.8	557.7	536.2	1958.6	1902.6	2399.2	3923.1
Total Liabilities	1297.7	1957.4	2760.6	3555.8	6489.4	8403.0	12922.6	18909.0
II. Assets (Use of Funds)								
3. Cash in Hand	27.5	45.3	62.8	79.9	107.1	185.3	222.8	339.0
4. Balances and Deposits with Other Banks	141.9	296.2	577.2	695.1	764.2	754.9	1077.0	1250.7
5. Loans to non-govt. Sectors	818.1	1092.6	1504.5	1820.9	3350.9	4401.2	6865.8	8552.2
6. Loans to Government	42.7	183.7	294.6	614.4	1511.8	1874.1	3393.2	6645.0
7. Other Assets ²	267.5	139.6	321.5	345.5	755.4	1187.5	1363.8	2122.1
TOTAL ASSETS	1297.7	1957.4	2760.6	3555.8	6489.4	8403.0	12922.6	18909.0

Note: ¹ Includes "Other deposits" of negligible amounts. ² Includes mainly fixed assets.

Source: BOT: Economic and Operations Report, Various Years.

Table 6.2(b). The National Bank of Commerce (NBC): Balance Sheet as at end of Selected Years. Figures in Percentages.

Liability/Asset Items	1967	1969	1971	1973	1975	1977	1979	1981
<i>I. Liabilities (Sources of Funds)</i>								
1. Deposits, Total of which:								
1.1 Demand Deposits	79.6	81.5	79.8	84.9	69.8	77.0	81.4	79.3
1.2 Time Deposits	52.4	47.6	43.2	46.7	44.3	51.3	53.6	49.4
1.3 Savings Deposits	15.9	24.5	28.2	28.4	17.9	16.4	18.9	21.2
	11.3	9.4	8.4	9.8	7.6	8.9	8.7	
2. Other Liabilities	20.4	18.5	20.2	15.1	30.2	23.0	18.6	20.7
Total Liabilities	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<i>II. Assets (Uses of Funds)</i>								
3. Cash in Hand	2.1	2.3	2.3	2.2	1.7	2.2	1.7	1.8
4. Balances and Deposits with Other Banks	10.9	15.1	20.9	19.5	11.8	9.0	8.3	6.6
5. Loans to non-govt. Sectors	63.0	55.8	54.5	51.2	51.6	52.4	53.1	45.2
6. Loans to the Government	3.3	9.4	10.7	17.3	23.3	22.3	26.3	35.1
7. Other Assets	20.7	17.4	11.6	9.8	11.6	14.1	10.6	11.3
TOTAL ASSETS	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Adopted from Table 6.2(a).

Trends in Total Deposits

Some indicators of trends in NBC deposits are shown in Table 6.3. The most important of these is the deposits to GDP ratio. According to this criterion, there was relatively rapid increase in NBC deposits during the period up to 1973, and this is reflected in the rise of the total deposits to GDP ratio from about 15 % in 1967 to 26 % in 1973. Moreover, it may also be seen from the Table that the increase in deposits during the period, 1967—73, was mainly due to interest earning deposits—of which ratio to GDP rose from about 5 % in 1967 to 12 % in 1973. After 1973, however, time and savings deposits generally declined, and the ratio of total deposits to GDP more or less stagnated—thanks to some rise in demand deposits, which offset the decline in interest earning deposits.

A comparison of Tables 6.3 and 6.4(a) indicates that the marked rise in time and savings deposits, especially during 1967—71, coincides with the period when inflation rates in the country were relatively low, and real interest rates on deposits mainly positive. In contrast, the period after 1973 was characterized with high rates of inflation, and mainly negative real rates of interest on deposits.

It may also be noted from Table 6.3 that the share of the private sector in the total deposits of the NBC declined from about 70 % in 1967 to 50 % in 1971, and thereafter picked up again to about 74 % in 1981. This suggests that the rapid increase in deposits, especially during 1967—71, was mainly due to the public sector. Moreover, looking at Table 6.2(b), it may be argued that much of the fall in private sector deposits was due to small saving accounts. As a result, the share of savings deposits—mostly undertaken by small savers—in the total liabilities of the NBC declined from about 11 % in 1967 to about 8 % in 1971. During the same period, the share of time deposits (mainly undertaken by large scale private savers and public enterprises) in the total liabilities of the NBC rose from about 16 % to 28 %.

The rise in the contribution of the private sector to the total deposits of the NBC from 1973 onwards was mainly due to an increase in demand deposits of the private corporate sector (as individuals are rarely allowed to open current accounts with the bank), with access to NBC overdraft facilities at subsidized real rates of interest (see Annex 6.1.).

The main conclusion from this section is that the NBC was unsuccessful in mobilizing private small-scale savings, with the result that the ratio of savings deposits to GDP maintained more or less a constant level during 1967—81.

Factors Influencing the Deposit Trends

Among the main factors that could have affected the observed trends in the NBC's deposits during 1967—81 are penetration and branch expansion (discussed in the previous section), as well as deposit interest rates.

Table 6.3. Tanzania: Analysis of Commercial Bank Deposit Performance, Selected Years 1967—81.
Values in TZS million, ratios as %.

Selected Indicators	1967	1969	1971	1973	1975	1977	1979	1981
<i>I. Composition of Deposits</i>								
1. Total Deposits (by Value)	1033.1	1595.6	2202.9	3019.6	4530.8	6500.4	10523.4	14985.9
Of which percentage shares of:								
1.1 Demand Deposits	65.9	58.4	54.1	55.0	63.4	66.3	65.9	62.4
1.2 Time + Savings Deposits	34.1	41.6	45.9	45.0	36.6	33.7	34.1	37.6
Total Deposits (%)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
of which shares held by:								
1.3 Private Sector	69.2	59.7	50.3	54.7	56.9	60.2	66.3	73.5
1.4 Public Sector	30.8	40.3	49.7	45.3	43.1	39.8	33.7	26.5
<i>II. As Ratios of GDP:</i>								
2. Total Deposits of which:	15.3	21.4	24.5	26.3	26.7	24.9	23.4	24.9
2.1 Demand Deposits	10.1	12.5	13.5	14.5	16.9	16.5	14.3	16.6
2.2 Time + Savings Deposits	5.3	8.9	11.0	11.8	9.8	8.4	11.1	8.3
2.3 of which Savings Deposits	2.1	2.4	2.4	2.9	2.8	2.7	2.6	2.5

Source: Calculated from Table 6.2(a). The GDP figures for the years up to 1977 were directly got from the National Accounts of Tanzania (various issues). For the rest of the period, Constant (1966) prices GDP data from the National Accounts were deflated by the National Consumer Price Index (NCPI) to get Current price GDP due to inconsistencies in the GDP deflators for the period after 1978 (see JASPA Report on Tanzania (1982) for a discussion of the inconsistencies).

Table 6.4(a). Nominal Interest Rates on Deposits of Major Financial Institutions and Inflation Rates, Annual Average in %.

Institution/Type of Deposit	1961	1962-66	1967-72	1973/74	1975/76	1976/77	1978-80
I. SAVINGS ACCOUNTS:							
1. Commercial Banks	3.50	3.00	3.50	4.00	4.00	4.00	5.00
2. Tanzania Housing Bank*	5.00	4.50	4.50	4.50	4.50	4.50	5.00
3. Post Office Bank	2.50	2.50	3.00	4.00	4.00	4.00	5.00
II. TIME DEPOSIT ACCOUNTS:							
a) 7-days Notice:							
4. Commercial Banks (minimum rate)	—	—	3.00	3.00	8.50	6.00	3.15
b) 3—6 months:							
5. Commercial Banks	4.50	3.50	4.00	4.00	4.00	4.00	4.00
c) 6—9 months:							
6. Commercial Banks	4.75	3.75	4.25	4.25	4.25	4.25	4.25
d) 9—12 months:							
7. Commercial Banks	8.00	7.00	6.50	4.50	4.50	4.50	4.50
e) 1—2 years:							
8. Commercial Banks	—	—	—	—	—	6.00	6.00
9. Tanzania Housing Bank	6.00	5.50	5.50	5.50	5.50	6.00	6.00
III. INFLATION RATE:							
(average annual rate as measured by Retail/National Cons.							
Price Index, 1970 = 100)	1.3	2.0	3.0	19.2	26.5	11.6	18.5
	(excl. 1972)						

Note: * For 1961—67 is represented by the First Permanent (E.A.) Ltd. and by the Permanent Housing Finance Co. during 1967—72.

Sources: Interest rates for the period prior to 1967 are from the Statistical Abstract of Tanzania, 1966; while for the rest of the period they were obtained from *Bank of Tanzania: Economic and Operations Report*, various issues. For the period 1961 through 1972, inflation Rates have been calculated from Retail Price Index figures adjusted from 1960 base year to 1970 base. The 1960 base year figures up to 1966 were obtained from various issues of Statistical Abstract of Tanzania, while for 1967 onwards they were obtained from Bank of Tanzania (opt.cit). The National Consumer Price Index, upon which the inflation rate after 1970 is based, is also published in the Bank of Tanzania's Report.

Tables 6.4(a) and 6.4(b) present the nominal and real interest rates respectively on deposits of various financial institutions in Tanzania, including the commercial bank (NBC) during 1961—80.

Table 6.4(b) illustrates two important facts: first, it shows that after 1971, when the rate of inflation in Tanzania rose up markedly, the real interest rates

Table 6.4(b). The NBC: Real Interest Rates on Selected Type of NBC Deposits and Growth Rates of Time plus Saving Deposits, 1967—81 (in %).

Year	Price	Savings Accounts	Time		Lending Rate (min.)	Real Growth Rate of Time + Saving deposits
	Index (NCPI) 1970 = 100		Accounts 3—6 months	9—12 months		
1967	2.2	1.3	1.8	4.2	4.2	13.0
1968	4.4	-0.9	-0.4	2.0	2.0	45.3
1969	2.1	1.4	1.9	4.3	4.3	27.1
1970	3.1	0.4	0.9	3.3	3.3	21.1
1971	5.0	-1.4	-1.0	1.4	1.4	16.1
1972	7.6	-3.8	-3.3	-1.0	-1.0	13.2
1973	10.6	-6.3	-6.3	-5.9	-5.1	-0.4
1974	18.4	-12.2	-12.2	-11.7	-11.3	-10.8
1975	27.0	-18.1	-18.1	-17.7	-16.5	2.0
1976	6.9	-2.8	-2.8	-2.3	-1.1	12.1
1977	11.4	-6.6	-6.6	-6.2	-4.8	-1.0
1978	11.2	-5.6	-6.5	-6.0	-3.3	19.2
1979	13.7	-7.7	-8.5	-8.1	-5.5	8.8
1980	30.4	-19.5	-20.2	-19.9	-17.6	-8.6
1981	25.7	-16.5	-17.3	-16.9	-14.5	4.8

Source: Calculated from Table 6.4(a). The method used is similar to that applied in Table 5.9(b).

on deposits declined to negative levels. Second, at least on the surface, the Table seems to indicate that Tanzanian depositors—contrary to the BOT's assumption—are quite sensitive to real rates of interest. This is vivid from a comparison of Table 6.4(b) with Table 6.3. In short, during the period 1967—71, when recorded inflation was relatively low and real interest on deposits mainly positive, though very low, the real rates of growth of demand deposits lagged behind those of interest bearing time and saving deposits. In the years after 1971, the real deposit rates of interest were all negative and, in real terms, time and savings deposits grew slower than demand deposits.

In the view of the very low positive and negative real interest rates on deposits during 1967—81, one may question the source of the recorded real increase, though very limited, in commercial bank deposits in the period. In my opinion, much of this little increase in deposits should be attributed to institutional factors: the absence of other saving instruments, the rapid expansion of the network of banking offices, and the introduction of the hire purchase arrangement by the NBC in 1969—to mention only the main ones.

The Introduction of Hire Purchase Arrangement by the NBC

Expatriate hire purchase companies closed their business in Tanzania in 1966 following the enactment of the Hire Purchase Act in November that year, intended to protect buyers in their dealings with sellers and credit institutions of hire purchase (see MacNeil (1966, p. 84)). The country remained without a specialized hire purchase institution up to 1969, when the NBC, after consultations with the BOT, established a hire purchase subsidiary—the Karadha Company. Despite the relatively high rate charged by the Karadha company—11.0 % plus 2.5 % commitment fee in case of commercial vehicles, for example—the demand for its credit facility was relatively high. By mid-1970, the Company had extended credit amounting to about TZS 26 million to 871 applicants, having rejected 747.

The rate at which the hire purchase facility was taken up reflects the degree to which it was instrumental in mobilizing savings, especially those of civil servants, through the so-called Berg-Bentzel effect.⁸

However, the company was subsequently directed by the Ruling Party's (then, the TANU) National Executive Meeting of November 1970 to discontinue financing the hire purchase of personal cars (which was the dominant durable consumer item financed by the scheme). The Party's directive was based on accusations that the facilities were being made available only to senior officers in the government. The BOT supported the discontinuation of the scheme because it placed an additional pressure on the foreign reserves, at the time when considerable demand pressure was being created by the public sector expenditure (cf. chapter 8).

6.3.2 Credit Extension by the NBC

As specialized institutions got created, the NBC ceased to lend on medium and long-term and specialized in short-term lending.⁹ The bank has predominantly lent on overdraft basis, i.e. potential borrowers are allocated a maximum amount up to which they may overdraw their accounts.

Nevertheless, small amounts of credit have been advanced in the form of commercial bills, usually of 30, 60, 90 and 120-days maturity. Moreover, the bank provides bridging finance, that is, short term credit to customers pending the arrival of long-term funds that have been contractually promised from other sources (domestic or foreign).

During the period 1967–80, approximately 85 % and 5 % of total domestic lending by the NBC was in the form of overdrafts and commercial bills respectively. Other types of lending accounted for an average of about 10 %.

The structure of NBC's domestic lending by method of lending is shown in Table 6.5.

The decline in the share of commercial bank lending by means of commercial

⁸ According to the Berg-Bentzel effect, individuals increase their savings in order to repay the credit they have received, see Berg (1983).

⁹ Short-term is defined as a period of less than a year.

Table 6.5. Structure of Domestic Lending by the NBC According to the Methods of Lending (Selected years, values in million TZS).

METHOD OF LENDING	1967 %	1970 %	1976 %	1980 %
1. Overdrafts	74.3	85.9	83.3	88.4
2. Commercial Bills	8.6	4.0	6.5	5.6
3. Other loans	17.1	10.1	10.2	6.0
Total in %	100.0	100.0	100.0	100.0
Total value of loans	818.1	1347.1	3673.4	7400.1

Source: Bank of Tanzania: Economic and Operations Report, Various Issues.

bill discounting is probably a reflection of the shrinkage that has occurred in the development of a securities market, and/or the turning of the parastatal sector (with easy access to overdrafts) into the major borrowers of the NBC.

Private and Public Sector Lending by the NBC

Immediately after the Arusha Declaration and nationalization of the banks, discussions arose whether the NBC should accommodate demands for credit by the private sector, whose growth was thought to contradict the principles of Ujamaa socialism stipulated by the Declaration. The discussions culminated in a recognition of the role that the private sector had to continue to play in the development process. It was stressed that the National Bank should offer maximum possible assistance to the public sector (including the cooperative sector), without denying accommodation to the private sector within the limits of the Finance and Credit Plan (see Nsekela (1971, p. 9)).

The NBC's lending criteria to the private sector are more or less similar to those used by commercial banks in the capitalist countries, and include a thorough analysis of credit worthness and availability of legal security (or collateral). The lending criteria to the public sector are essentially the same as those of the private sector, with the exception that the importance attached to last-resort security (i.e. the precaution taken by the bank to recover its credit in the event of the collapse of the borrower's business) is much less when lending to the public sector (see Nsekela (1971, p. 23)). Moreover, interest rates—fixed by the BOT according to 'national priorities' (see chapter 5)—are generally lower for loans extended to the public sector. Thus, according to the interest rate structure effective in 1971 and 1981, the rates shown in Annex 6.3 were charged, depending on the type of economic activity and ownership.

First, one may interpret the Annex 6.3 as an indication of the priorities of government policy. However, in view of the enormous acceleration of inflation after 1972, the differentials were robbed of whatever original significance they

might have had. Moreover, the rates are abstract, in the sense that one cannot find any real justification for them.

Rates of interest on loans ranged from 6.5 % to 10.0 % with public sector enterprises and cooperatives being charged slightly lower rates than the private sector, and foreign owned business being charged the maximum rates. The ceilings, upper and lower, of commercial bank loan rates were revised from 6.5—10.0 % in 1971—72 to 5.0—10.0 % in 1973—74, then to 6.0—10.0 in 1975. To reduce the impact of external price shocks following the oil-price increase of 1974, the rate ceilings were lowered to 5.75—6.50 % in 1976, but then readjusted to 6.0—10.5 % in 1977, and subsequently to 7.5—11.5 % in 1978, a range which was maintained up to 1980. The changes in the lower and upper limits were accompanied by corresponding adjustments in the loan rates according to economic sectors and by ownership (private or public).

Despite the adjustments made in the loan rates in the period after 1971/72, for the whole of that period the real lending rates were negative.

Distribution of NBC Credit Between the Private and the Public Sectors

The distribution of domestic bank credit across the public and private sectors of the economy during 1967—80 is shown in Table 6.6. The public sector is divided into the central government and other official entities. The latter includes local government authorities up to 1974 after (which they were not allowed to borrow directly from banks), East African Community bodies, and the parastatals (government enterprises) which alone accounted for over 95 % of total lending to 'other official entities' during the period under review.

Table 6.6 shows that the total domestic commercial bank credit increased rapidly during 1967—80. With the exception of the year 1977—78, when the growth rate was about 7 %, the nominal growth rate was never below 12 % in the period 1967—80; and recorded an average of about 23 % for the 14-years. Relatively low rates were recorded during 1970—72, following the credit squeeze introduced by the Bank of Tanzania in 1970 with a view of curbing the strong monetary expansion of 1969. The peak rates were 58 %, 29 % and 31 % registered in 1974, 1975 and 1978 respectively. The large increases during 1974—75 were due to the oil and grain crises and the sharp price and wage increases, as well as from resulting rises in working capital requirements.¹⁰

It is also evident from Table 6.6 that the credit expansion was mainly directed to the public sector. Both the central government and the parastatal sector increased their borrowing from the commercial banks thereby *crowding-out* the

¹⁰ The price and wage changes were effected administratively following the recommendations of an interministerial Oil Crises Task Force formed in 1974. (For a thorough discussion of the measures implemented to curb the crises, see Green et al. (1980, pp. 36—41)).

Table 6.6. Total Commercial Bank Credit (Corporate + Government Sectors)*.

Year	Central Government		Other Official Entities (mainly parastatals)		Total Public Sector		Private Sector		Total Credit	
	Value	%	Value	%	Value	%	Value	%	Value	Growth rate (%)
1967	42.7	5.0	68.9	8.1	111.6	13.1	740.2	86.9	851.8	—
1968	143.6	13.9	144.5	14.0	288.1	27.9	745.8	72.1	1033.9	21.4
1969	183.7	14.6	304.7	24.3	488.4	38.9	766.6	61.1	1255.0	21.4
1970	152.4	10.4	681.2	46.4	833.6	56.8	634.1	43.2	1467.7	16.9
1971	294.6	17.1	909.3	52.7	1203.9	69.8	520.6	30.2	1724.5	17.5
1972	459.2	23.7	851.6	43.9	1310.8	67.6	629.1	32.4	1939.9	12.5
1973	614.4	26.1	1243.0	52.8	1857.4	78.9	495.1	21.1	2352.5	21.3
1974	902.2	24.3	2207.7	59.3	3109.9	83.6	611.5	16.4	3721.4	58.2
1975	1511.8	31.6	2631.4	55.0	4143.2	86.6	642.8	13.4	4786.0	28.6
1976	2157.7	37.3	3077.3	53.3	5235.0	90.6	543.2	9.4	5778.2	20.7
1977	1874.1	30.2	3648.5	58.9	5522.6	89.1	675.0	10.9	6197.6	7.3
1978	2130.7	26.3	5005.1	61.7	7135.8	88.0	976.7	12.0	8112.5	30.9
1979	3393.2	33.8	5602.4	55.9	8995.6	89.7	1028.4	10.3	10024.0	23.6
1980	4871.8	40.1	6135.9	50.5	11007.7	90.6	1136.7	9.4	12144.4	21.2

Note: * Lending to the non-financial sectors only.

Source: Adapted from Bank of Tanzania: Economic and Operations Report, 1981.

Table 6.7. Analysis of NBC Lending by Industrial Sectors, Selected Years (1967—80) (in percentages).

Industrial Sector	1967	1970	1973	1976	1980
1. Commerce (Trade plus marketing of Agricult. produce) of which:	58.1	57.5	63.3	59.3	73.5
1.1 Marketing of Agric. Produce	23.3	20.8	31.2	31.1	63.1
1.2 Export Produce	18.1	10.3	3.8	10.9	1.4
1.3 Trade in Capital Goods	1.8	3.9	1.2	2.7	0.3
1.4 Wholesale, Retail and Other Trade	14.9	22.5	27.1	14.6	8.7
2. Agricultural Production	12.5	12.7	4.9	4.2	6.0
3. Mining and Manufacturing	14.0	15.9	19.8	28.3	8.9
4. Building and Construction	3.0	2.6	2.0	0.8	1.9
5. Transportation	1.3	3.4	2.2	1.2	1.8
6. Tourism	—	1.8	0.6	1.0	0.5
7. Specified Financial Institutions	1.1	2.4	4.5	1.4	1.0
8. Public Administration	0.5	0.2	0.1	—	0.7
9. Other	9.5	3.4	2.6	3.8	5.7
TOTAL	100.0	100.0	100.0	100.0	100.0
TOTAL VALUE	818.1	1347.1	1820.9	3673.4	7400.1
Total Value as % of GDP	11.4	16.4	15.8	16.1	14.2

Source: Adapted from BOT: Economic and Operations Report, various issues. GDP figures are from National Accounts of Tanzania, deflated by the NCPI for the period after 1973.

private sector. As a result, the share of claims on the central government in the total claims of the commercial banks on domestic sectors rose sharply from 5 % in 1967 to about 40 % in 1980; that of claims on the official entities (or simply the parastatal sector) also rose from about 8 % in 1967 to 51 % in 1980 (having reached a peak of 61.7 % in 1978). The overall effect of the increased commercial bank lending to the government and the parastatal sector has been to raise the share of the total public sector in total commercial bank credit from about 13 % in 1967 to over 90 % in 1980. This change reflects the rapid expansion of the parastatal sector after the nationalizations associated with the Arusha Declaration.

Performance of NBC in Lending to non-central Government Economic Sectors

As seen from Table 6.7, the structure of NBC lending by the economic sectors has changed dramatically during the post-nationalization period. First, it is notable that lending for agricultural productive activities declined sharply after 1970, due to the formation of a specialized Rural Development Bank in 1971. Second, there was an increase in lending to the manufacturing sector (including mining) during 1973—76, which is attributable to the introduction of foreign

exchange planning—causing a shift from the use of foreign supplier credit to more use of domestic sources of loanable funds by the private sector. Third, during 1967—80, there was a sharp rise in the share of agricultural marketing in the total NBC credit. This rise may be a reflection of the National Milling Corporation, NMC (the parastatal with the monopoly of food crop purchases) financial problems. The deficits of the NMC—financed mainly by NBC overdrafts—absorbed about 80 % of the total credit extended for agricultural marketing activities by the NBC since 1979/80.

Finally, it may be observed from Table 6.7 that in the period after 1976, total lending to the non-central government domestic sectors fell in real terms—as evidenced by the decline in the ratio of lending to GDP. Table 6.2(b) suggests that the decline was due to increased lending to the central government by the NBC.

Concluding Observations

In this chapter I have discussed the National Bank of Commerce (NBC) as virtually the only commercial bank in Tanzania Mainland from 1967 onwards. The discussion started by noting that during 1967—70 (the first phase in the development of the bank), the NBC operated more or less like any other commercial bank with a profit maximizing objective. After 1970, characterized as the second phase in NBC's development, the bank was subject to increased direct controls by the government, associated with the introduction of annual financial planning. Moreover, during 1970—81, the NBC turned mainly into a lender to the public sector—giving up to about 90 % of its loans to the public sector in 1980 compared to only about 13 % in 1967. The implication is that during 1970—81 (and perhaps thereafter as well), the NBC could not have operated like a private profit maximizing commercial bank.

As far as deposit mobilization (which was noted to account for an average of 80 % of total sources of funds of the bank during 1967—81) is concerned, it was observed that the performance of the NBC in this function was mainly influenced by the BOT' assumption that small-scale African savers are more responsive to improvements in banking facilities than to interest rates. As a result of this assumption, the NBC concentrated its deposit mobilization efforts on the expansion of bank branch offices/agencies and penetration into remote areas of the country. This policy was not quite successful, especially in the 1970s, as it was counteracted by a schedule of negative real interest rates on deposits. Real increases in amounts of deposits mobilized by the NBC were recorded only in the period up to 1973 (especially 1967—71)—mainly coinciding with the first phase in the bank's development—when the real deposit interest rates were mainly positive (although quite low). Thus, the deposit to GDP ratio of the NBC rose markedly from about 15 % in 1967 to 26 % in 1973, and thereafter more or less stagnated up to 1981. NBC's performance was particu-

larly poor in the mobilization of small savings deposits.

With regard to the use of funds by the NBC, it has been noted that lending to the public sector took over 75 % of the total funds loaned during the period after 1973. Moreover, it has been observed that the central government alone has taken an increasing share in the total loans issued by the NBC. This share rose from about 3 % in 1967 to 35 % in 1981.

Chapter Seven

The Development of Non-Bank Financial Intermediaries During the Post-Arusha Declaration Period (1966—1980)

Introductory Remarks

Following the Arusha Declaration, the commercial banks and the insurance companies were immediately nationalized. Other financial institutions were left to operate with minor modifications. However, during 1967—70, important institutional changes took place in Tanzania's economic set-up, and these raised the need for reorganization of the financial sector. The main changes were two-fold:

- i) the public sector became increasingly responsible for the development of the various productive sectors of the economy;
- ii) the NBC which up to the end of 1970 provided short-term commercial credit, as well as medium and long-term finance for the public corporations and for the private sector, was felt to be inadequate in long-term financing as it still remained committed to traditional commercial banking principles.

7.1 The formation of Specialized Investment and Development Banking Institutions in Tanzania during the Post-Arusha Period

Development banks are generally defined as public institutions through which governments attempt to influence, by a complex of measures (including interest rate subsidies, tax allowances etc.), the flow of finance into specific "neglected" sectors of the economy.¹ However, by 1970, Tanzania had sectorally specialized public development promotion and holding corporations that

¹ "Neglected" in the sense that under the private profitability criteria applied by the traditional institutions, these sectors seem unprofitable; while in terms of social criteria, flows of finance to these sectors are desirable. For some more discussion of this, see for example, Khatkhate and Villanueva (1978).

seemed to have more or less the similar objectives as those relegated to development banks elsewhere.

In the light of this, one is tempted to question, first, whether the creation of the development banks in early 1970's was not going to duplicate the functions of the already existing holding corporations (parastatal holding companies). Secondly, one may also ask, whether the NBC and/or the BOT—which were then public owned—lacked the management capacity of providing the financial services expected from the development banks.

In Tanzania, the development banking institutions were envisaged to play two roles:

- i) act as a channel of foreign loan funds to the financing of productive enterprises, and
- ii) act as “an instrument for proper regulation, evaluation, coordination and supervision of the use of public finance for the parastatal sector through objective project analysis” (see Budget Speech 1972/73).

In essence, the above are the same functions charged to the holding parastatal corporations: Moreover, by 1970 the NBC had been relieved of most private borrowers as the parastatal sector with fewer institutional units had turned into a major client of the NBC (c.f. the previous chapter).

It might seem, therefore, that there was no theoretical basis for rushing into the formation of specialized financial institutions in form of development banks in the beginning of 1970s.

Nevertheless, motivated by the experience of other developing countries in the field of banking, the government entered into a reorganization of the financial structure, which started with the formation of the Tanzania Investment Bank (TIB) in November 1970, to provide development finance to all productive sectors—but with emphasis on large scale industry. Shortly afterwards, in February 1971, the President approved the bill establishing the Tanzania Rural Development Bank (TRDB), to specialize in the financing of the rural sector, taking over the activities of the National Development and Credit Agency (NDCA). The Tanzania Housing Bank Act was passed in 1972, and the Tanzania Housing Bank (THB) started operations in January 1973, after taking over the assets and liabilities of the semi-private Permanent Housing Finance Company (PHFC). The THB was to specialize in the financing of rural and urban residential, office and commercial buildings.

In the following sections of this chapter, I attempt to discuss the experience of the three development banks, together with other non-bank financial institutions—including the National Insurance Corporation (NIC), the Pension Funds, and the Post Office Savings Bank (POSB)—in Tanzania during 1967–80. The discussion will focus on the sources and uses of funds by the respective institutions. It will be argued that by the nature of their sources and uses of funds, the parastatal holding companies in Tanzania, including, among

Table 7.0. The Financial Structure of Tanzania as represented by Shares of Various Financial Institutions in Total Assets (in percentages).

Institutions of Finance	1968	1973	1976	1978	1980
1. Central Bank (Bank of Tanzania)	22.4	24.8	19.1	19.0	21.9
2. Commercial Banks (NBC)	54.0	57.2	63.4	60.1	61.0
Total Monetary Institutions 1 + 2	76.4	82.0	82.5	79.1	82.9
3. Post Office Saving Bank	1.6	1.3	0.9	1.0	0.9
4. National Development Credit Agency	2.7	—	—	—	—
5. National Cooperative Bank	5.4	—	—	—	—
6. Cooperative Societies/Credit Unions	0.3	0.2	0.2	0.2	0.1
7. Tanzania Rural Development Bank (TRDB)	—	2.2	1.3	1.8	1.4
Total Specialized Agric. Credit Institutions (4 + 5 + 6 + 7)	8.4	2.4	1.5	2.0	1.5
8. Tanganyika Development Finance Co. Ltd.	0.9	1.6	1.2	1.1	0.7
9. Tanganyika Finance Company (TAFCO)	1.3	0.6	0.3	0.2	0.1
10. National Development Corporation (NDC)	2.1	3.2	1.2	0.3	0.9
11. Mwananchi Development Corporation (MDC)	0.2	—	—	—	—
12. Workers Development Corporation (WDC)	0.2	—	—	—	—
13. Diamond Jubilee Investment Trust	1.2	0.8	0.4	0.3	0.2
14. Industrial Promotion Services (IPS)	0.4	0.2	0.1	0.1	0.1
15. Tanzania Investment Bank (TIB)	—	0.9	7.2	10.1	6.9
Total Specialized Industrial Credit Inst. (8 + 9 + 10 + 11 + 12 + 13 + 14 + 15)	6.3	7.3	10.4	12.1	8.9
16. Instalment Credit Institutions/Karadha Co.	—	0.5	—	—	—
17. Tanzania Permanent Housing Finance Co.	0.8	—	—	—	—
18. Tanzania Housing Bank (THB) plus WFHDF	—	1.5	1.0	2.5	2.0
19. National Provident Fund (NPF)	2.5	2.7	2.2	1.7	1.2
20. Parastatal Pension Scheme (PPS)	—	—	—	—	0.4
21. National Insurance Corporation (NIC)	4.0	2.3	1.5	1.6	2.2
Total Specialized Contractual Savings Inst. (19 + 20 + 21)	6.5	5.0	3.7	3.3	3.8
OVERALL TOTAL	100.0	100.0	100.0	100.0	100.0

Source: Annex 9.3. Calculated from Annex 9.3.

others, the National Development Corporation (NDC), should be regarded as “quasi-financial” institutions.

The significance of the institutions to be discussed in this chapter in the financial structure of Tanzania during 1967—80 may be judged from Table 7.0. According to that Table, each of the institutions mentioned above accounted for at least about 1 % of the total financial assets in Tanzania in any one of the years after their creation.

7.2 Tanzania's Development Banks: Common Features

The Tanzania Investment Bank (TIB), Tanzania Rural Development Bank (TRDB), and Tanzania Housing Bank (THB) were formed by corresponding legislations in 1970, 1971 and 1972 respectively. The TIB was charged with the objective of providing medium- and long-term finance mainly for the industrial sector. The TRDB was given the same responsibility with respect to the rural sector, while the THB was required to offer the same type of financing to the housing sector.

Apart from their main objectives, the development banks are supposed to provide technical assistance and advice with respect to their specific sectors, and administer any special funds that may be offered by the government or foreign donors for the development of particular projects within the respective sectors.

The development banks have a similar management structure. On the basis of broad policy guidelines issued to each of the banks by the Minister for Finance (in consultation with the Governor of the BOT), a Board, consisting of 6—8 Directors, makes the major decisions regarding the operations of the respective bank. The chairman of the Board (appointed by the President), is at the same time the managing director of the bank, and is responsible for ensuring that the Board's decisions are properly implemented.

A general manager, appointed by the Minister for Finance in consultation with the Board, is responsible for the day to day management of each bank's affairs.

7.2.1 Sources of Funds for the Development Banks

The Acts establishing the three development banks distinguish between two main sources of finance, viz: ordinary capital resources, and special funds. In line with this distinction, the financial operations of each of the banks are classified into 'ordinary operations'—involving the use of ordinary resources—and "special operations"—related with the use of special funds.

a) Ordinary Capital Resources:

Ordinary resources of each of the banks are usually made up of the authorized capital, funds raised by borrowing (mainly from external sources), and funds or income—including the general reserve fund—which has been derived from operations in which the ordinary capital resources have been used.²

² The authorized capital for each of the banks was TZS 100 million, subscribable only by the government and parastatals.

Another important source of ordinary capital, but only for the THB up to 1980, is various types of saving and time deposits mobilized by the banks.³

b) Special Funds:

The development banks administer special funds placed with them by the government or other agencies (mainly foreign donors), for use in specified projects related with the respective bank's objectives. Special fund resources include funds accepted into any special project fund, repayments of loans made from special funds, recovery of guarantees honoured out of special fund resources, as well as income derived from operations in which any special funds were used.

It seems that the main purpose for the distinction between ordinary and special funds was to accommodate foreign donors wishing aid money to be used for specific projects.

7.2.2 Uses of Funds by the Development Banks:

The uses of funds by the development banks within their respective sectors include direct lending (on medium and long-term) from ordinary and special funds, investment in equity up to a maximum of 10 % of the paid-in capital plus reserves, the purchase of material inputs (such as fertilizer in the case of TRDB) necessary for production in the specific sector and reselling them on credit, and the guarantee of loans made by other institutions for the development of the respective sector.

In the conduct of financial operations, the following principles are (according to the respective Acts) observed: financing of only economically and technically sound projects, maintenance of a reasonably diversified portfolio of investments, requirement of collaterals in lending, priority financing of public sector projects, and achievement of maximum turnover of invested funds by selling equity investments whenever appropriate.

The maximum amounts of loans extended to individual projects (or borrowers) is determined by reference to the cost of the projects and the borrowers capacity to meet part of the costs, as well as the borrower's repayment capacity. In the determination of loan maturities, the productive life cycle of the assets financed are considered.

³ The THB was empowered to mobilize such deposits right from inauguration, while the TRDB was empowered to accept all types of deposits from 1979.

7.3 Lending Performance of the TRDB, 1971—80

The TRDB's lending performance by type of activity and by ownership is presented in Tables 7.1(a) and 7.1(b). Total lending by the Bank rose from TZS 36 million in 1971/72 to TZS 203 million in 1974/75, but remained more or less at the 1974/75 level up to 1979/80, implying a major fall in real terms given that inflation is estimated at about 15 % per annum during 1975—80. In 1980/81, TRDB lending declined by about 51 % to TZS 101 million, which is only about a half of the amount lent in 1974/75 in nominal terms, and only about a quarter in real terms.

It is also seen from Table 7.1(a) that the bulk of the TRDB loans have been for seasonal inputs, corresponding to short-term loans repayable within 1—2 years. Such loans have accounted for up to 50—70 % of total annual lendings of the bank.⁴

Table 7.1(b) shows that during 1971—74 the TRDB extended the bulk of its loans through the cooperative movement. Thereafter, the Ujamaa Villages took an increasing share and in 1976 became the major channel for TRDB credit, partly as a result of the abolition of the cooperative societies and unions in 1976. As a result, in 1979/80, about 56 % of total TRDB credit was channelled through Ujamaa Villages as compared with only about 14 % in 1971/72. In the year 1980/81 when the bank's lending declined sharply, due to bad weather, which adversely affected the demand for agricultural credit, the Ujamaa Villages alone accounted for about 90 % of the total credit extended. The other main recipients of the TRDB credit during 1971—80 were the parastatal crop authorities, which have accounted for an average of about 20 % of total credit, and farmers' associations, which took some 16 % of total lending in 1979/80. Loans to individuals have accounted for a relatively small share (5—7 %) in the total loans granted by the bank.

7.3.1 The TRDB Lending Rates:

From Table 7.2, one notes that in the ten-year period 1970—80, when the inflation rate (estimated by the National Consumer Price Index, NCPI) averaged 14 % per annum, the nominal short-term lending rate of the TRDB was changed three times: in 1975, when it was lowered to 6.5 % per annum, in 1976, when it was raised back to 8.5 % p.a., and in 1978 when it was reduced to 7.5 %

⁴ This aspect of TRDB lending raises the problem of the adequacy of its sources of finance. The sources of finance for the bank have been of long-term nature (up to 1980), which should desirably be deployed for long-term financing. It is for this reasoning that the TRDB Act was amended to allow the bank accept short-term of deposits from 1979.

*Table 7.1(a). Lending by the TRDB, 1971—81 (as percentages of the total lending for the year)**.*

Purpose of Loans	1971/72	1972/73	1973/74	1974/75	1979/80	1980/81
Seasonal Input	58.5	57.5	53.5	69.7	64.1	73.1
Rural Transport	18.4	8.0	18.9	7.7	4.8	1.1
Livestock	1.4	7.2	16.1	18.5	8.0	1.2
Crops Establishment	2.9	22.7	8.0	0.5	14.6	0.1
Commercial Ventures	1.4	—	1.7	1.3	—	—
Farm Machinery	2.9	1.9	0.8	2.0	0.7	12.8
Fisheries	—	0.8	0.8	0.5	0.7	0.6
Storage	14.8	1.8	0.3	0.1	1.3	0.4
Off-farm processing	—	0.2	—	—	5.8	10.7
Total	100.0	100.0	100.0	100.0	100.0	100.0
TOTAL LENDING, TZS million	35.9	107.9	160.7	203.3	207.9	101.2

Notes: ** The percentages might not add up to 100 due to rounding up. The sums disturbed across borrowers do not exactly tally with the actual loans disbursed due to differences in sources of data.

Sources: TRDB Annual Report 1973/74, p. 8 and 1974/75 p. 9; Annual Economic Survey (of Tanzania) 1979/80; Budget Speech 1981/82.

*Table 7.1b. Distribution of TRDB Loans by Type of Borrowers, 1971—81 (as percentages of the total loans made during the year)**.*

Borrowers	1971/72	1972/73	1973/74	1974/75	1979/80	1980/81
Cooperative Societies	32.0	28.0	21.0	19.0	0.8	0.1
Ujamaa Villages	14.0	19.0	20.0	39.0	55.6	90.3
District Dev. Corporations	4.0	4.0	17.0	6.0	0.4	0.1
Cooperative Unions	34.0	30.0	16.0	5.0	—	—
Parastatal Companies	6.0	7.0	14.0	20.0	20.7	2.3
Farmers Associations	2.0	12.0	12.0	10.0	16.4	—
Partnerships	1.0	—	—	—	1.0	0.3
Individuals	7.0	0.1	0.1	1.5	5.1	6.9
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0

Notes: ** The percentages might not add up to 100 due to rounding up. The sums distributed across borrowers do not exactly tally with the actual loans disbursed due to differences in sources of data.

Sources: TRDB Annual Report 1973/74, p. 8 and 1974/75 p. 9 (mimeo); Annual Economic Survey (of Tanzania) 1979/80; Budget Speech 1981/82.

p.a. The general tendency was to reduce the nominal rates, when the economic scenario of high inflation required their increase, both in order to meet the increasing expenses of the bank and to reflect the increasing profitability of investment associated with the rising prices. The result of the negative *real* lending rate implicit in the above figures has been the failure/ineffectiveness of the

Rural Bank to increase the *real* size of its revolving funds, and to render the efficiency of finance through the bank minimal.⁵ One reason for the low lending rates has been the belief that the demand for capital for agricultural purposes is undermined by high rates of interest, but much available evidence seems to suggest that other factors, including the availability of extension services, relaxation of the requirements for collateral and better education of farmers on the significance of bank credit, play a more significant role in inducing increased demand for agricultural credit.⁶ Indeed, Due's (1978) study on the credit conditions of Ujamaa Villages and small scale private farmers in Tanzania, indicate that the demand and repayment of credit is mainly influenced by the expected prices of farm products, rather than by the rates of borrowing funds.

Table 7.2 also shows that the TRDB's long-term lending rate has for the most of the period been lower than the short-term rate. This is a reflection of the attempts to induce farmers and other rural entrepreneurs the incentive of expanding their farm activities, which in most cases require long-term credit. Apparently, African farmers are very much averse to longterm debt (probably due to instability of rural incomes), with the result that even with the lower long-term rates the demand for long-term credit has remained far below that of short (seasonal input) credit, as witness the small proportion of this type of credit in the total TRDB lending.

Despite the relatively low lending rates of the TRDB during 1970–80, the bank managed to make some profits, although relatively low when measured in real terms. This was made possible by the fact that the cost of the funds was heavily subsidized by the government and international organizations. Thus, TRDB net profits rose from TZS 0.2 million in 1971/72 to TZS 11.1 million in 1974/75. Data is not available for the size of profits made after 1975, but one should expect them to have fallen given that up to 95 % of the bank's revenues are derived from interest charges, which had to decline due to the reduction in the lending rates and the volume of credit extended.

7.3.2 Criticisms Against the TRDB Operations

The Rural Bank has been criticized for the following counts:

- a) *Concentration of its lending on one crop*, namely tobacco, and hence in the two tobacco growing regions of the country—Tabora and Iringa. During

⁵ For detailed discussion of the effects of maintaining negative deposit and lending rates, see Shaw (1973, ch. 4).

⁶ See, for example, A. Taylor, "The Demand for and Supply of Credit" for a Sierra Leone case, in *Savings and Development* No. 1, 1979-III, pp. 24–58.

Table 7.2. TRDB Lending Rates of Interest, 1970—80. (Nominal rates in %).

Year	Short-term lending rate	Long-term rate
1970		
1971		
1972	8.50	
1973		
1974		
1975	6.50	7.50
1976	8.50	
1977		
1978		
1979	7.50	
1980		

Source: Bank of Tanzania.

1971—80, up to about 60 % of the TRDB seasonal input credit, accounting for 60—70 % of total lending, went to the tobacco areas (see JASPA, Basic Needs Mission Study on Tanzania (1982, p. 193)). Of the total loans approved by the bank during the period, about 65 % went to Iringa and Tabora regions (out of a total of about 20 regions in the country). The concentration on tobacco has been partly explained by the fact that the Tobacco Authority (TAT), through which most of the credit is channelled, has a prepared package of inputs for which credit is applied from the TRDB and which has proved to have a great impact on the tobacco yields (thereby enhancing the capacity to repay the loans). Another factor that has accounted for the bias in favour of tobacco has been the bank's policy to favour the extension of credit to single-crop activity rather than to multi-activity-farming.

- b) *Non-acceptance of deposits or any other instrument in mobilizing domestic savings.* In the original Act, the TRDB was not empowered to accept deposits from the public. This may partly explain the concentration of the bank's activities in a few regions, because if the bank had to mobilize resources throughout the country it would have been more active in all regions. The result of allowing, from 1982, the TRDB to accept all types of deposits has been a return to the situation prevailing during 1967—70, when the NBC competed with the National Cooperative Bank (NCB) in the supply of commercial banking services, with the latter concentrating on rural transactions. The only difference now is that the two competing banks will be wholly state-owned. Such competition might lead to some improvement in the services offered by the NBC to its customers.

These costs are likely to increase due to duplication of branch offices, decrease in economies of scale, and increased overall operating costs (due to increase in advertisement costs etc.).

It would, therefore, seem that the proposal made by the Bank of Tanzania to design and arrangement where funds could be transferred from the commercial bank (the NBC) to meet the short-term capital requirements of the TRDB, at the guarantee of the central bank and at a reasonable cost, might be quite appropriate (see Bank of Tanzania, Report (1982, Appendix II)).

- c) *Bias towards rich farmers and export, rather than food crops.* The bias against food crops is mainly due to the lack of security, since such crops are usually sold in local markets, rather than through Crop Authorities, which in the case of export crops guarantee the retrieval of the loan at the time of marketing. The insistence by the TRDB that the borrowers put up at least 25 % of the capital needed, so that its loans provided only 75 % of the capital needed, has implied that only relatively rich farmers have afforded and qualified for medium- and long-term loans from the bank (see Due (1978, p. 70)).

- d) *Poor loan recovery performance:* According to Bank of Tanzania statistics, the repayment position of the TRDB loans was as follows:

From Table 7.3 the rate of loan recovery seems to have worsened from 1976 after the dissolution of the cooperatives, and the conversion of the Ujamaa Villages into the main channel for reaching small peasants. Indeed, in years 1979/80—81, for which I do not have reliable statistics, the rate of loan repayment appears to have dropped significantly from the already low level of 1976/77 (cf. JASPA Report (1982, p. 194)). This is also true of interest payments. The reasons for the sharp decline in the TRDB loan and interest recovery rates after 1975/76 are partly due to the relatively less consciousness, as well as poor accountability for the loan repayment on the part of Ujamaa Villages, as compared with the cooperatives.

The interviews conducted by Due (1978) revealed that most members of Ujamaa Villages were not informed of the obligation to repay the loans, so that they assumed they were government grants. Moreover, the villagers, as opposed to the cooperative members, were in most cases given the loans in form of an already decided input-package, implying that they had no opportunity of determining the input-mix by themselves. The implication of this has been to depress the feeling of responsibility to repay, especially where the use of the inputs fails to generate enough capacity to repay the loans.

Related to the low repayment of the Ujamaa Villages is the diversion of inputs offered on credit basis from the cash crops (for which it is intended) to food crops, most of which are produced and sold on an individual rather than communal basis.

The conclusion from the analysis of the TRDB operations may be stated as follows: During the period after the Arusha Declaration, the problems facing the financing of the rural sector, viz: failure to mobilize small peasant savings and negligence of the small farmer in credit extension by formal financial in-

Table 7.3. TRDB Loan Recovery: Selected Indicators.

	1974/75	1975/76	1976/77
% of Loans overdue for at least a year in total loans outstanding at end-of-year	18	19	27
% of Loans Overdue interest in total interest payments due at the end of year	38	36	67

Source: Bank of Tanzania.

stitutions, emphasis on financing of export crops and negligence of food crops, as well as high default rate, have more or less remained untackled. In particular, mobilization of small peasant savings—especially by specialized agricultural finance institutions—has remained poor. Although, to some limited extent, credit has reached the small farmer via the Ujamaa societies, it has done so at a relatively high rate of interest subsidy, and high default rate. Lending has continued to favour export/cash crop production. Nevertheless, during the 1970s, the failure in agricultural financing may largely be attributed to weaknesses in the institutional set-up of the rural sector with regard to credit extension. These weaknesses were exacerbated by frequent government induced changes in the rural structure—such as the introduction of the Ujamaa settlements, dissolution of the cooperatives in 1976 and their resurrection in 1982—and the shaky legal standing of the TRDB.

7.4 The BOT's Rural Finance Fund⁷

Related with the functioning of the TRDB is the Rural Finance Fund established by the BOT following the Amendment of its Act in 1978. The fund was created with an initial capital of TZS 35 million, and subsequently, varying amounts have been allocated to it from the BOT's annual profits.

The Rural Finance Fund is used, on terms and conditions determined by the Bank for purposes related to financing of rural development:

- a) Medium- and long-term loans or advances (with maturity of 1—20 years to banks or designated financial institutions for the purpose of financing rural development, or for enabling the institutions to lengthen the maturity of any loan/advance they have granted, provided that the respective institutions

⁷ Special funds with similar purposes with respect to other sectors of the economy were established according to Article 46 of the BOT Act in 1980/81. These include the Industrial Finance Fund and the Export Credit Guarantee Fund.

- can substantiate that the failure for timely repayment of the loan/advance was due to effects of natural disasters or other exceptional circumstances.
- b) Purchase of debentures, bonds and other negotiable instruments of medium and long-term nature, offered publicly by banks and other financial institutions for the purpose of rural financing.
 - c) Guaranteeing of loans and advances granted by banks and designated financial institutions to the rural sector.
 - d) Subscription to share capital of a bank or other financial institution that may be formed for the purposes related to rural financing.

However, up to 1980, preparations were still being made for the use of the Rural Finance Fund according to the above terms of reference. Up to then, the funds were wholly invested in government securities.

7.5 The Tanzania Investment Bank (TIB):

Overall Performance during 1970—80

The TIB's performance during 1970—80 was similar to that of TRDB in several aspects. First, it relied almost totally on the government and foreign institutions as its sources of funds, and abstained from deposit mobilization. Second, the distribution of TIB loans by geographical regions of the country and by economic sectors was relatively imbalanced. Third, in the period under review, the TIB had a relatively high loan default rate.

Thus, for instance, of the total loans sanctioned by the TIB during 1971—78, 85 % went to only six of the twenty regions in the country; with the Dar es Salaam region alone accounting for about 50 % for the total loans extended.⁸ As far as the sources of funds are concerned, in the period after 1974, the TIB relied on foreign institutions to cover up to about 70 % of its total sources of funds, while the government contributed the rest. With regard to loan recovery, taking the year 1979, for example, it may be observed that the outstanding defaults at the end of the year were about one-third of the total loan commitments made by the bank during that year.⁹ Moreover, of the total loans overdue, 50 % were overdue for more than one year.

Lending by the TIB during 1970—80 mostly favoured large scale, capital in-

⁸ The figures sighted here were obtained from Bank of Tanzania, Report (1980, Appendix I) and (1982, Appendix II).

⁹ The loan commitment for that year rounded up to TZS 234 million. See the Economic Survey, 1979/80, p. 36.

tensive industry.¹⁰ In 1972, for example, the latter sector accounted for about 53 % of the total loans, followed by transport (18 %), mining (14 %), corporate agriculture (12 %), and tourism (3 %).

With respect to the distribution of loans by ownership of borrowers, lending was mainly to the parastatal sector, which accounted for 71 % of the TIB loans in 1979 (and probably in the rest of the period). Mixed ventures (split 50—50 between public and private) accounted for about 20 %, while wholly private projects accounted for only 10 % of the total lending by the bank. This is yet another indication that credit formation during the post-Arusha Declaration period was mainly geared to the expansion of the public sector.

The poor loan recovery by the TIB is partly explained by the concentration of its loans in capital intensive and imported-inputs-dependent public sector firms most of which were running at low capacity utilization (and hence losses) due to shortage of foreign exchange to import inputs (see Wangwe (1983)). Moreover, the absence of a strong legal framework upon which the bank could enforce loan repayment, especially from public enterprises, has impinged on loan recovery.

7.6 The Tanzania Housing Bank (THB)

The Sources and Uses of THB Funds during 1973—80

Granted the relatively low rate of return on investment in housing, the Government in establishing the Housing Bank took caution of the fact that the bank's operations might be hampered by lack of financial resources, if its sources of funds remained limited to the "ordinary capital" and "special funds" resources characteristic of the TIB and the TRDB. Thus, the THB was statutorily allowed to include deposits mobilization and a special statutory fund, called the Workers and Farmers Housing Development Fund (WFHDF), among the other sources characteristic of the TIB and the TRDB.

It may be seen from Table 7.4 that during 1973—79, deposits (mainly time) formed the major source of funds for the THB—accounting for an average of about 74 % of the total sources in the period. During the same period, the WFHDF contributed about 25 % of the total funds, while the share capital paid-in by the government accounted for only about 1 % of the sources of funds. On the average, the THB did not rely on grants from the government

¹⁰ Indeed, the TIB is not intended to finance the small scale industry, as its minimum lending amount is limited to TZS 100 000, which is relatively large for a small scale business.

*Table 7.4. The Source and Uses of THB Funds, Selected Years, 1973—79.
(End of year figures, in TZS millions).*

LIABILITIES/ASSETS	1973	1975	1977	1979
I. LIABILITIES (Sources)				
1. Deposits, Total	71.5	127.8	228.7	365.0
of which:				
1.1 Savings Deposits	27.2	38.5	78.7	—
1.2 Time Deposits	44.3	89.3	150.0	—
2. Workers and Farmers Housing Development Fund (WFHDF)	—	68.5	83.0	96.6
3. Other Liabilities (Share Capital paid by Government)	2.6	28.4	28.4	28.4
TOTAL LIABILITIES	74.1	224.7	340.1	490.0
II. ASSETS (Uses)				
4. Housing Loan Commitments	42.2	112.3	187.8	236.0
5. Other Assets (incl. Cash + reserves and real estate)	31.9	112.4	152.3	254.0

Notes: * Calculated as residual.

Source: THB annual Reports for the years 1973—77, and Annual Economic Survey (United Republic of Tanzania), 1979/80.

to finance its activities. Foreign sources accounted for a negligible share in the sources of funds, and this distinguishes the operations of the THB during 1973—79 sharply from those of the other two development banks.

7.6.1 Savings Mobilization by the THB

Among the three development banks, it was only the THB which mobilized savings through the acceptance of savings and time deposits during 1972—80.

Savings deposits (including time) mobilized through the THB's campaign "Savings and Housing", form the main source of funds for the THB. By 1977, the THB had opened 18 regional branch offices in the 20 regions of Tanzania in order to facilitate the mobilization of deposits, and other regional activities of the bank. The network of THB branches remain relatively poor when compared with that of the NBC and the Post Office Savings Bank, each of which had over 100 bank branch offices, excluding the agencies.

As seen from Table 7.4 the THB accepts three types of deposits: saving, deposit and fixed-time deposit.

The savings accounts of the THB are aimed at mobilizing the small savings of peasants and workers. Thus, the minimum accepted on these accounts is relatively low, TZS 40, and the interest offered was slightly higher than that of the POSB and the NBC on similar types of accounts (cf. Table 6.4a).

As seen from Table 7.4, the savings deposits of the bank grew rather rapidly during 1973—1977, and probably in 1978—79 for which we do not have a breakdown of total deposits as well. It may be shown that the savings deposits of the THB grew much faster than those of the NBC and the POSB, despite the poorer branch network of the former. This might be attributed to the higher deposit interest rates offered by the THB, as well as the more rigorous campaigns through the mass media, plus the introduction of a lottery in which the winners have their accounts credited with the prizes won. Moreover, by allowing relatively liberal terms of withdrawing deposits—such as the possibility of drawing any amount on demand under emergency cases—the bank has offered an attractive assets to the small saver.

The THB has also operated a scheme, more or less similar to that of the NBC, of periodically visiting farmers at their crop selling places and workers at their industrial sites on pay-days.

Another factor accounting for the fast growth of the THB's saving deposits is the precondition that the applicants of loans from the THB have to contribute more than 5 % of the cost of the house for which the loan is applied. This amount is sometimes raised in form of periodic savings in the THB accounts (see Yona (1978, p. 65)). Moreover, to the extent that loan repayments are sometimes made through savings accounts opened at the Bank, the balances (and number of such accounts) has tended to rise over years, reflecting the increase in the number of loans granted.

Deposit and Fixed Time Accounts:

These are directed at savers with large amounts for relatively longer periods of time. Some of these accounts are pension and provident funds of private and public companies, who are attracted by the relatively high deposit rates of the THB. The deposit and loan rates of the THB are shown in Table 7.5.

During the period 1973—77, the only financial institution that accepted fixed time deposits for over one year was the THB, which offered a deposit interest ranging from 5.5 % to 6.5 % per annum for deposits of which withdrawal was after 1—3 years. In 1978, time accounts for a period of 3—5 years were in-

Table 7.5. Deposit and the Minimum Lending Rates of the THB and Inflation Rates, 1973—80 (Interest rates are nominal and in %).

End of year	Saving Deposits	Time Deposits			Min.Lend. Rate	Inflation Rate
		1—2 yrs	2—3 yrs	3—5 yrs		
1973—75	4.5	5.5	6.0	—	8.5	18.7
1976—77	4.5	6.0	6.5	—	5.0	9.2
1978—80	5.0	6.0	6.5	7.0	7.5	18.4

Source: Bank of Tanzania.

Table 7.6. Growth of Total Deposits of the THB, and Ratio of Total Deposits to GDP, 1973—79. (End of Year figures, values in TZS millions).

	1973	1974	1975	1976	1977	1978	1979
Total Deposits	71.5	74.5	127.8	188.9	228.7	278.8	365.0
Growth Rate (in %)	—	4.2	71.5	47.8	21.1	21.9	30.9
Total Deposits as % of GDP	0.6	0.5	0.8	0.9	0.9	0.9	1.1

Source: Same as Table 7.4, with GDP figures from National Accounts of Tanzania, 1980.

roduced, and subject to a deposit interest of 7.0 %. From the same year, the commercial bank (NBC) also started to operate time deposits for periods of 1—5 years, similar to those of the THB. At the same time, the BOT instructed that the interest rates offered by all financial institutions on similar types of deposits should be equal.

Table 7.6 presents the growth rates of the THB's total deposits, as well as the ratio of the total deposits to GDP during 1973—79.

On the aggregate, the total deposits of the THB grew at a commendable pace in the period after 1974. As a result, the ratio of the total deposits to GDP rose gradually from 0.5 % in 1974 to 1.1 % in 1979.

The funds available from these deposit schemes are usually used by the THB for financing special short-term investments, such as the building of housing estates, whereby a large number of low/medium-cost houses are constructed by the bank and then sold for cash to individuals and/or institutions, before the deposits come up for redemption.

7.6.2 The WFHDF as a source of THB Funds:

The WFHDF is a special fund to which all employers of at least ten workers contribute an amount equivalent to 2 % of their wage bill. This fund is administered by the THB on behalf of the government in financing low-cost housing for workers in urban areas and farmers in rural parts. The fund is intended mainly to benefit farmers and workers who organize themselves into housing cooperative associations or registered Ujamaa Villages. The WFHDF was established by a parliament Act of 1974.

The fund is used for three main purposes:

- financing low-cost housing projects of employment based housing cooperatives;
- financing housing in rural areas;
- financing low-cost housing in the country's new capital city (Dodoma) under construction.

The interest rate charged on loans made from the fund is relatively low, at

5 % per annum, compared with 8.5—10.0 % charged on other lending by the THB. By 1979, the volume of the fund had increased over six-times to record TZS 97 million, as against TZS 15 million in 1974.

7.6.3 Loans and Grants as sources of funds for the THB:

As a result of the relative success in mobilization of funds through the deposit saving schemes, and the WFHDF, the THB relied minimally on borrowing during 1973—79. The Bank took only two soft loans from the International Development Agency (IDA) during 1973—77 (see Yona (1978)). However, the THB received sizeable grants for financing low-cost housing from the Swedish and Norwegian aid agencies, SIDA and NORAD. These grants accounted for some 1—2 % of total annual disbursement of loans by the THB during 1976—79.¹¹

Loan repayments and income from investment have been regular sources of THB finance from the second half of 1970s.

7.6.4 Lending by the THB

As of early 1980s, the THB was the main source of formal housing credit in Tanzania. During the period 1973—80, lending to finance housing accounted for about 50 % of the total use of funds by the THB (see Table 7.4).

According to the Act, the THB—like the TRDB and the TIB—is expected to apply the lending criteria usually used by modern banking institutions in extending loans. Nevertheless, it goes without saying that the fact that the THB (and the TRDB and TIB as well) is state-owned implies that it is required to reconcile profitability with social criteria. Thus, the THB management has attempted to adapt the operational principles laid down by the Act (Article 12 to the Tanzanian situation, as these were seen to be “unworkable if applied in the Tanzanian environment” (Yona 1978, p. 67)).

In this connection, the THB's management introduced loan limits, new types of security that could be accepted, and workable guidelines regarding the use of loans and repayment methods.

From 1973, individual housing loans of the THB were limited to a minimum of TZS 1 000 and a maximum of TZS 80 000 (raised to TZS 150 000 in 1980). Within these limits, four categories of loans have been distinguished by size. Interest rates are also differentiated according to the category of loans, with the lowest and highest categories of loans carrying interest rates of 55 and 10 % per annum respectively.¹²

¹¹ These data have been obtained from various annual plans, and may therefore be taken as only rough approximations.

¹² The amount that may be borrowed within the specified categories depends on the size of the

The interest rate differentiation aims at encouraging borrowers to take smaller loans and cover a large part of the building cost by themselves.

As security against loan default, the THB accepts first mortgage on land, but it is only in the urban areas, where most of the land is surveyed, that borrowers can mortgage land. Land holdings by the majority of the rural population remain unsurveyed and not settled on a firm legal system. Thus, the bank has virtually no legal security for loans extended to rural areas, and therefore requires rural borrowers to take a loan protection insurance policy with the National Insurance Corporation (NIC).

With the view of making sure that loans are used for intended purposes, the disbursement of loans by the THB is made in instalments. In order to get the amount due in the next instalment, the bank must be satisfied that the previous instalment was appropriately used.

Other types of loans and facilities offered by the THB

The THB also financed the production of local building materials in the country. Loans granted for such purposes are not subject to the upper limit, but the borrower has to subscribe at least 25 % of the cost of the project.

The other facilities available at the THB include: house plans at low prices, advice to borrowers and other clients on the use of building materials and site layouts, as well as assistance on the formation of housing cooperatives.

7.6.5 The THB Lending Performance during 1973—80

The composition of total THB lending during 1973—79 is given in Table 7.7.

Two main points are worthy noting from the THB's lending during 1973—79, as presented in Table 7.7:

- a) during the period 1973—79, there was a general upward trend in the total number of houses financed by the bank from some 1 600 houses in 1973 to 4 600 houses in 1979. However, the trend in loan commitments by values was interrupted in 1976, when the value fell by 6.5 % from the previous year; and again in 1978 when the value of commitments also fell below that of the year before. Apparently, the average value of the housing units financed declined after 1975. The average size of loans depends on the proportion of loans to rural and to urban areas, as the average value of rural housing units is generally lower than that of urban units. Thus, for example, the drop in

house, income of the borrower (including that of his wife), age of borrower and other possible saving to be made by borrower. The regulation require that loan repayments be made before the official retirement age (60 years), and not to exceed 25 % of household'd gross income in any one year/month.

Table 7.7. THB Lending by Rural and Urban Areas, and number of Housing Units financed, 1973—79. (Values in TZS millions).

	1973	1974	1975	1976	1977	1978	1979
Loan Commitments:							
a) Total							
i) Value	42.2	47.8	112.3	105.0	187.8	185.3	236.0
ii) Housing Units	1595	1811	2754	3383	4197	4213	4573
of which:							
b) Rural							
i) Value	—	7.3	28.3	50.0	88.0	79.1	101.9
ii) Housing Units	—	358	1005	2171	2585	2606	2815
c) Urban							
i) Value	42.2	40.5	84.0	55.0	99.8	106.2	134.1
ii) Housing Units	1595	1453	1749	1212	1612	1607	1758

Source: Same as Table 7.4.

the value of commitments recorded in 1976 is attributable to increased financing of rural dwellings—the number of which rose by about 116 % in 1976 as compared with 1975, while the number of urban housing units financed during the same year rose only by 23 %.

- b) THB has been particularly successful in reaching rural areas, especially after the introduction of the WFHDF. As a result, in the period after 1974, the housing units financed by the bank have been more or less evenly distributed between the urban and the rural sector, although the share of the urban sector in the value of loans granted has been slightly larger.

7.7 Parastatal Holding Companies: The Case for “Quasi-Financial Institutions”

In economic literature, holding companies are usually treated as non-financial institutions. This is done under the assumption that such companies do not engage in financial intermediation. However, in Tanzania, the parastatal holding companies are, by the nature of their financing and disposal of funds, “semi-financial institutions”, in the sense that they conduct both financial intermediation, and some non-financial business.

In order to provide some indication of the degree to which these types of institutions act as financial intermediaries, more or less similar to the development banks, I shall briefly analyse the sources and uses of funds of the National Development Corporation (NDC).

The point of departure is that the NDC, and indeed the other holding

parastatal companies in Tanzania, do receive “deposits” in the form of loans from the government and from other domestic institutions, as well as from external sources; a relatively large portion of which is *relent* (at a higher rate of interest) to other institutional borrowers. This suggests that credit control by the Bank of Tanzania, in order to be effective, must encompass measures to influence the behaviour of these companies, which account for a relatively large part of the financial flows.

7.7.1 The National Development Corporation (NDC):

The NDC was originally established in 1962 under the name Tanganyika Development Corporation, with an initial capital of TZS 10 million, fully subscribed by the government. In 1964, it was reorganized, and renamed the NDC, combining the assets of the Tanganyika Agricultural Corporation (worth TZS 11 million), and some other government interests in industrial enterprises (including interests in the Mwadui Diamond Mines, Tanganyika Packers and Nyanza Salt mines)(2).

According to the 1964 Act of establishment, the NDC’s primal objective is to speed up industrial development by undertaking ventures directly, or by enhancing the participation of other investors. However, a look at the sources and uses of funds by the NDC suggests that the corporation, like many other holding parastatals in Tanzania, has also partly acted as a financial intermediary.

The Sources of NDC Funds:

The main sources of the NDC funds are given in Table 7.8. According to the Table, the capital fund—made up of the capital paid-in by the government, and other government grants—formed the main source of funds for NDC during 1967—80.

Table 7.8 shows that the capital fund increased more than 6-fold in 1967—80 mainly on account of government grants. This is contrary to the original expectation that the NDC was to become a self-financing institution, and is due to the new role of the NDC after the Arusha Declaration.

The second major source of NDC finances in short- and long-term borrowing, mainly from the government and from external sources. About 40 % of total NDC funds was obtained from this source during the period prior to 1980. It should be remembered that the above two sources, do as well form the major means of financing the development banks (with the exception of the THB).

Uses of Funds by the NDC

Table 7.8 indicates that during the period 1970—80, the NDC’s lending (through short-, long- and bridging-finance) took up about 35 % of the total

Table 7.8. Sources and Uses of NDC Funds: Selected Years, 1967—80. (End of Year Figures, in Millions of TZS).

Sources	1967	1970	1975	1980
Capital Fund	96.5	147.6	183.8	616.6
of which:				
Government Grants*	22.3	111.8	178.1	609.4
Capital Reserves	12.0	19.8	—	—
Revenue Reserves	46.8	84.8	45.3	42.6
Borrowings + other short term credits	97.3	142.5	208.5	94.1
TOTAL SOURCES	252.6	394.7	437.6	753.3
Uses				
Fixed Assets	8.6	10.9	13.6	14.4
Investments in Equity	187.0	266.5	224.4	296.5
Loans (short- and long-term + Bridging Finance)	26.0	112.2	173.6	268.4
Short-term Deposits	32.7	27.5	—	—
Other Assets	—1.7	—22.4	26.0	174.0
TOTAL USES	252.6	394.7	437.6	753.3
Loans of NDC Affiliates Guaranteed by NDC Assets	14.9	—	460.3	226.3

Notes: * Includes profits from sale of investments; ** Short-term credits are defined to include overdrafts, short-term bank borrowing and other current liabilities.

Source: NDC Annual Report, various (adapted from).

uses of funds by the corporation. During the same period, the share of equity investments—the major use of NDC funds—was just about 50 %. For comparison, equity investment by the development banks, where lending is the main use of resources, is limited to a maximum of 10 % of the paid-in capital plus reserves (see previous section). This, however, suggests only a minor difference, especially when it is recognized that the volume of funds disposed by the NDC by far exceed those of any development bank taken singly.

NDC as an Industrial Bank

Despite the fact that the NDC is essentially a state holding company in industry, it has especially prior to the introduction of financial planning in 1971 and after 1978, acted as a source of credit to its member group of companies. A number of these companies were under-capitalized from the time of their formation, with the result that they faced frequent liquidity problems, which the NDC sought to mitigate by setting up a special arrangement, whereby the subsidiaries and the associate companies could obtain *short-term credit* and also deposit their temporary excess cash reserves (see NDC, Annual Report 1971, pp. 17—18). It paid a deposit rate of 4.50 % per annum and charged 6.00 % per

annum for short term credit. Both the deposit and the lending rates were relatively more attractive than those of the NBC (the commercial bank), and consequently the arrangement flourished, earning the NDC some TZS 1 million, just about enough to cover the NDC's total wage bill for its headquarter employees in 1970/71 (see Van der Laar (1968), NDC Annual Report 1971).

Nevertheless, this financial arrangement was criticized for enabling the NDC group to by-pass credit controls on and of the NBC, with the result that some of the companies got credit even where they would not have been counted as creditworthy by the NBC's criteria. As a result, it was decided by the monetary authorities to abolish this arrangement in 1971, when there was a general credit squeeze (see Bank of Tanzania, Reports (1970, 1971)). Even after the abolition of the special financing arrangement discussed above, the NDC has continued to offer considerable amounts of short-term loans and bridging finance to its associate companies. This is clear from the current asset structure of the NDC, in which these two types of finance combined account for an average of about 43 % of the total current assets outstanding in each of the years 1968—78.

The other main financial intermediation function that was pursued by the NDC during the period 1967—80 was that of guaranteeing member company loans. The NDC guarantees overdrafts, bills of exchange and short-term loans of its subsidiaries from the commercial banks.

The total amounts of total short-term credits guaranteed by the NDC is shown at the bottom of Table 7.8. This amount rose systematically up to TZS 643 million in 1978, after which it declined to TZS 226 million due to the slackening of industrial activity during 1979—80.

The above figures suggest that the NDC is indeed an institution to be reckoned upon in the matters pertaining to credit control.

7.7.2 Generalization of NDC's Experience to Other Parastatal Holding Companies

The constitutions of the major parastatal holding companies—the TTC, the NAFCO, the STAMICO, the NCICm the SMS and others—have been designed along the same lines as that of the NDC, and their sources of finance are principally the same.¹³ All of them are mainly financed from the government budget and from foreign borrowing. Analogously, the uses of funds by these

¹³ The TTC (Tanzania Tourist Corporation) holds interests in the tourist sector, NAFCO (National Agricultural Food Corporation) holds in food production, TWICO (Tanzania Wood Industries Corporation) holds in timber, STAMICO (State Mining Corporation) in the mining sector, NCIC (National Chemical Industries Corporation) in the manufacture of chemicals, and the SMC (State Motor Corporation) deals with motor vehicles.

companies in the promotion of the development of their respective sectors/sub-sectors are more or less the same as those of the NDC, viz: equity participation, long- and medium-term lending, direct investment in projects, provision of short-term bridging finance and loans for working capital purposes, as well as guaranteeing of credit applications of member companies to the other financial institutions.

Apparently, therefore, the holding parastatal companies are from a financial point of view very similar to the development banks. This similarity suggests that the operations of the holding companies, like those of the development banks, must be given due concern by the central bank. This is particularly important in the light of the relatively large-scale of the financial operations of the parastatals.

2.8 The Tanganyika Development Finance Company Limited (TDFL)

In the period after the Arusha Declaration (1967), the TDFL, whose formation and activities up to 1966 were briefly discussed in the previous chapter, retained its status as an "internationally based and commercially operated development organization" (see TDFL Report and Accounts (1975, p. 7)). However, in the financial sector that evolved by 1973, the TDFL occupied special position as the only financial institution treating the private sector on an equal basis with the public sector in evaluating projects to be financed. Indeed, one may argue that while all the financial institutions in Tanzania are required by their respective constitutions to operate commercially and profitably, the only one financial institution that has *de jure*, had the capacity to operate so is the TDFL. The others are incapacitated to do so by the fact that they operate under selective constraints imposed by the government.¹⁴

Thus, the TDFL continues to emphasize commercial profitability, a high degree of domestic resource utilization, and capacity to save foreign exchange as the main criteria for evaluating projects seeking finance from the institution.

As mentioned in Chapter 4, the sources of TDFL funds are mainly foreign—accounting for over 75 % of total loanable funds during 1967—80. The rest of the funds (about 25 % of total) were contributed by the Tanzania government.

¹⁴ One of the main constraints which I have in mind is the one requiring the institutions to favour the public sector in credit extension. The TDFL is also affected by some of the controls, but to a lesser extent.

Table 7.9. TDFL: Investment Disbursements, Commitments and disbursements as a Ratio of GDP. (Values in TZS million).

Year End	Actual Investments (cumul. from 1962)	Cumulative Commitments	Act. Disbursements as ratio of GDP (%)
1967	21.4	27.1	0.3
1970	33.0	47.9	0.4
1975	76.7	109.9	0.4
1978*	213.4	212.0	0.7
1980*	388.1	412.0	1.1

Source: TDFL, Report and Accounts, various years; * from the Annual Ec. Survey.

Unlike the development banks, the TDFL does not specialize in any particular sector in the use of its funds. However, during 1967—80, its investments were concentrated in agriculture and fishing, general consumer industries, textiles and knitwear, food beverages and alcohol.¹⁵ The growth of TDFL's total investments in selected years during 1967—80 is shown in Table 7.9.

As seen from Table 7.9, total investments (in form of loans) disbursed by the TDFL in 1975 were already more than three times those of 1967. By 1980, the cumulative disbursements were about five times as much as in 1975. Corresponding with these increases was the rise in the TDFL total investments to GDP from 0.3 % in 1967 to 1.1 % in 1980.

7.9 The National Insurance Corporation (NIC)

The insurance business was nationalized immediately after the proclamation of the Arusha Declaration. The Insurance (Vesting of interests and Regulation) Act of 1967 established the state-owned National Insurance Corporation (NIC), in which the assets and liabilities of the nationalized, mainly foreign, insurance companies were vested.

As mentioned in Chapter 4, the significance of insurance companies as financial institutions lies in their ability to mobilize considerable amounts of funds, particularly through contractual savings of a large number of life insurance policy holders.¹⁶ In this context, the 1967 Insurance Act, giving the monopoly

¹⁵ Thus, for example, in 1972, of the total TDFL investments, about 13 % were in agriculture and fishing; 16 % in general consumer industries; 18 % in textiles and 19 % in food, beverages and alcohol.

¹⁶ Even as far as funds generated through general business (including fire, accident and marine insurance) is concerned, it may be said that although the reserves are contingent in nature, they contain a hard core of permanent resources.

for conducting insurance business in Tanzania to the NIC, was mainly aimed to control the use of the large funds that were accruing to foreign insurance companies, and most of which they invested outside the country (c.f. Chapter 4).

The NIC conducts both life and non-life (general) insurance, as well as some limited amount of reinsurance (from 1980). In conducting its business up to 1974, the NIC was supported by a number of local and foreign insurance brokers, but thereafter all licenses for private brokers were withdrawn. The State Insurance Brokers was formed, with a majority share-holding of the NIC, and given the monopoly of brokerage.

The NIC has 13 regional branch offices and slightly over 200 agencies.¹⁷ However, its staff, which rose from about 900 in 1975 to 1 400 in 1980, has remained relatively poorly trained—a fact that might have impinged on its performance.¹⁸

NIC's Performance

On the overall, during 1975—80 (see Table 7.10), total gross premiums of the NIC (life plus non-life) grew almost 4.4 times. During the same period, the consumer price index rose 2.7 times, suggesting that there was a substantial real increase in the gross premiums.

Sources of NIC's Loanable Funds

The only major source of the NIC's funds are the reserves from its various classes of insurance. A substantial part of the reserves, however, is constituted by the life business. During 1975—79, the latter accounted for about 60 % of the total reserves of the NIC (see Table 7.11).

Table 7.10. The NIC: Gross Premiums, Selected Years. (Values in TZS million).

	1975	1976	1977	1978	1979	1980
1. Gross Premiums (total)	127.7	165.2	246.1	253.4	305.6	515.5
of which:						
Life Premiums	36.0	48.8	71.4	82.8	94.5	98.0

Sources: The value of government securities held by the NIC was obtained from BOT: Economic and Operations Report, 1982. Other figures NIC: Annual Reports (various).

¹⁷ The network has remained more or less the same since 1970.

¹⁸ For example, as of 1980, there were only *two* employees with internationally recognized insurance qualifications (see, Insurance Report of Tanzania, A working report, Skandia, Stockholm).

Table 7.11. The NIC: Sources and Uses of Funds, 1975—79. (In TZS million).

	1975	1976	1977	1978	1979
I. SOURCES					
Reserves (total)	186.6	247.9	367.6	435.2	517.6
of which:					
Reserves in Life business	108.9	148.3	209.7	274.7	351.1
II. USES					
Value of Government Bonds held	167.9	225.0	347.3	335.5	446.2
Other Lending	18.7	22.9	20.3	99.7	71.4
TOTAL USES	186.6	247.9	367.6	435.2	517.6

Sources: Same as Table 7.9.

Investment of Funds by the NIC

The NIC invests mainly in government stocks and bonds. As seen from Table 7.11 about 90 % of total reserves of the corporation were invested in government paper in 1975, and this proportion declined to about 77 % in 1978 when the government borrowing requirement was reduced by improved budgetary performance (see also Chapter 8). Nevertheless, as the borrowing requirement of the government increased in the years after 1978, the proportion of NIC's investments placed in government paper also rose, to some 86 % in 1979.

The remainder of the NIC funds are invested in properties, in mortgage loans for building flats and commercial premises, in shares and debentures of first class companies (mainly parastatals), in short term deposits and in loans against life policies. In particular, life policy holders can, after three years of their life policy contract, obtain loans of up to 90 % of the surrender value of the policy. These loans have become quite popular, as one of the easiest ways of obtaining credit without the collateral of real security (see Castelli (1975, p. 331)). As a result of the rapid increase in such credit by the NIC, the central bank found it appropriate to exert control over such lending. Thus, the NIC has been included in the group of scheduled financial institutions, or what is known under Article 50 of the Bank of Tanzania Act as "Specified Financial Institutions", which are subject to direct control by the central bank.

7.10 Social Security Schemes

In Tanzania, social security schemes are still in their infancy.¹⁹ The social security and social insurance schemes existing in the country are devised (by the government, which controls them) to cover people who are employed, against the risks of old age retirement, death before retirement and sickness as well as other life hazards whilst in the period of employment.

At present, the most social security institutions are the NPF and the Parastatal Pension Scheme (PPS), covering all employees in the state-owned enterprises. The latter was established only in 1980, so our interest here will be centred on the NPF, which started operations in 1965 (c.f. Chapter 4).

The NPF

From 1968, membership to the NPF has been compulsory for employers with at least three employees. Workers themselves contribute 5 % of their monthly earnings, while employers are supposed to contribute 7.5 % of their wage bill to the NPF. These contributions are capitalized at a nominal rate of 3.5 % annually (effective from 1970), which is relatively unattractive given the high rate of inflation.

As mentioned in Chapter 4, benefits are payable from the NPF on retirement, sickness or disablement, and on cessation of employment due to marriage or emigration.

According to Table 7.12, net contributions of the NPF—by employers and employees—increased at an average of 14.8 % nominally per annum during 1967–80. This represents an average real increase of about 4 % per annum, given that inflation rate (as measured by changes in the National Consumer Price Index, NCPI) averaged 11 % per annum during the same period.

Uses of Loanable Funds by the NPF

The NPF loanable funds are invested in government treasury bills and stocks. The investments outstanding, as seen from Table 7.12, increased from about TZS 52 million in 1967 to about TZS 195 million in 1980. As a consequence, investment income has become an important source of funds, contributing up to about 29 % of total loanable funds in 1980.

The NPF alone held about 16 % of total government stock outstanding in December 1980.

¹⁹ Reference is hereby made of modern as opposed to traditional African social security schemes. For a thorough discussion of the latter, see, for example, Irukwu (1979, Ch. 1).

Table 7.12. The National Provident Fund: Sources and Uses of Funds.
(Values in million TZS).

Years	Net Contributions by members	Sources of Funds Income from Investment	Total	Uses of Funds Investment	Other payments*
1966/67	49.0	3.4	52.4	48.3	4.1
1967/68	48.6	7.4	56.0	51.0	5.0
1968/69	49.5	10.2	59.7	50.3	9.4
1969/70	61.3	14.3	75.6	60.3	15.3
1970/71	66.5	15.7	82.2	65.7	16.5
1971/72	69.0	22.5	91.5	63.2	28.3
1972/73	85.6	24.0	109.6	85.8	23.8
1973/74	100.7	32.2	132.9	100.6	32.3
1974/75	135.3	37.8	173.1	126.3	46.8
1975/76	171.9	49.4	221.3	192.7	28.6
1976/77	165.1	59.6	224.7	147.7	77.0
1977/78	176.1	74.5	250.6	179.5	71.1
1978/79	160.8	86.8	247.6	177.0	70.6
1979/80	189.3	77.7	269.0	194.7	74.3

Sources: Tanzania: Annual Economic Survey, various.

7.11 The Post Office Savings Bank (POSB), 1966—80

As pointed out in Chapter 4, during 1950—65, the POSB was, by significance, second to the commercial banks in mobilization of deposits in Tanzania. In the period 1966—80, the POSB became third, after the NBC and the THB, by the order of importance in deposit mobilization. As will be evident from the discussion that follows, the decline in the role of the POSB might be attributed to the poor performance of the bank in deposit mobilization during 1966—80.

The sources and uses of funds by the POSB are given in Table 7.13, while some indicators of deposit performance are shown in Table 7.14.

Table 7.13 shows that savings deposits were the only source of funds for the POSB. Growth in deposits during 1966—80 may better be understood from Table 7.14. According to the Table, the real interest rates on the POSB deposits were not only negative through-out the period, but also declined dramatically from a negative of about 1 % in 1966 to a negative of 11 % in 1980. This might explain the relatively low growth rates in the deposits, which only managed to keep pace with growth in real GDP. As a result, the POSB total deposits to GDP ratio remained constant, at an average of about 0.5 %, during 1966—80.

Against the relatively poor performance in deposit mobilization, it should be noted that the number of depositors in the POSB more than doubled during

Table 7.13. POSB: Sources and Uses of Funds in Selected Years, 1966—80.
(Figures are in TZS million).

Liabilities/Assets	1966	1968	1971	1974	1977	1980
I. Liabilities (Sources)						
Savings Deposits	35.1	38.0	49.0	77.0	112.9	213.4
Total Liabilities	35.1	38.0	49.0	77.0	112.9	213.4
II Assets (Uses)						
Government Securities	21.3	24.8	42.1	73.5	105.9	224.5
Other Assets (mainly Cash reserves)*	13.8	13.2	6.9	3.5	7.0	—11.1

Notes: * Calculated as residual.

Source: Adapted from BOT: Economic and Operations Report, Various.

Table 7.14. POSB: Deposit Performance Indicators, 1966—80. (Annual Averages).

Indicators	1966-69	1970-73	1974-77	1978-80
1. Real Interest Rate on POSB Deposits (%)	—0.7	—3.6	—9.9	—10.9
2. Real Growth Rate of Deposits (%)	2.6	4.8	0.2	5.7
3. Deposits to GDP Ratio (%)	0.5	0.6	0.5	0.5
4. No. of Depositors	232	294	389	524

Source: Same as Table 7.13 (GDP figures were obtained from Tanzania: National Accounts).

1966—80. Moreover, the POSB is relatively well spread across the country with a network almost comparable in size with that of the NBC.²⁰

The POSB's Use of Funds

As seen from Table 7.13, the POSB invests almost all its funds in government securities, which are less remunerative than alternative investments. As a result, in the face of increased nominal deposit rates, as well as price and wage inflation—especially in the second half of 1970s—the POSB has been squeezed between the rising operating costs and the relatively “static” sources of income. Thus, towards the end of 1970s, the POSB's balance sheets showed substantial losses, which had to be met (by law) by the government.

With a view of ensuring that the POSB operates on profitable basis, the Bank

²⁰ In 1980, for example, the POSB had 143 departmental branches and 184 agencies. For comparison, the NBC had 107 banking branch offices and 223 agencies.

of Tanzania (in 1982) has proposed that the POSB be allowed to diversify its activities, by undertaking "more remunerative lending business instead of investing all its funds in low-return Government stock" (Bank of Tanzania, Report (1982, p. 56)).

7.12 Other Financial Intermediaries During 1967—80

Two other financial intermediaries, of private origin, operated in Tanzania during the period under review. These were the Diamond Jubilee Investment Trust and the IPS—the origins of which were described in Chapter 4. Nevertheless, in 1967—80, the shares of these institutions in the financial structure declined to negligible levels, and I have thus chosen not to discuss them here.

Concluding observations

In this chapter, I have discussed non-bank financial intermediaries during 1967—80, which, taken together, accounted for a share of up to about 20 % in the financial structure of Tanzania in the period (see Table 7.0). The discussion suggests that after the Arusha Declaration (1967), financial intermediation in Tanzania became concentrated in a relatively few state-owned institutions. These institutions, with the exception of the THB and the POSB, did not mobilize deposits, but relied entirely on grants and loans from the government, as well as from external sources.

As for the institutions that mobilized deposits, the THB and the POSB, remarkable growth was registered only by the THB, of which the deposits to GDP ratio rose from 0.6 % in 1973 to 1.1 % in 1979. This rise was mainly due special savings mobilization schemes applied by the bank. Both in the case of THB and POSB, real negative interest rates on deposits was a factor that retarded the growth in deposits (see, for example, Table 7.13).

With the exception of the THB and the TDFL, which gave much of their lending to the private sector, the use of funds by the other non-bank financial institutions was mainly directed to the public sector (including the cooperatives). More specifically, the TRDB, the TIB, and the Parastatal Holding Companies directed their funds mainly to the parastatal sector, while the NIC, the NPF, and the POSB invested mainly in government bonds.

On the overall, granted that the majority of the financial institutions that operated in the country during 1970s did not mobilize savings, but rather financed the portion of their funds due from domestic sources by subventions from the government budget, one may say that the degree of financial intermediation in Tanzania was relatively low in the period.

Part Three:
Evaluation and Conclusions

Chapter Eight

The Money Supply Process in Tanzania, 1966—80

Introductory Remarks

In chapter 5, it was concluded that financial planning in Tanzania during 1970—80 was unsuccessful, in the sense that most of the targeted rates of growth in the main monetary aggregates—particularly the money supply—were overshoot. A question of interest is what were the main causes for excessively high rates of monetary expansion, and hence deviation between planned and actual growth rates of money supply. Of all the monetary aggregates, it is the money supply which raises special concern, first of all because it is the one directly related with all the other aggregates, and second, because it is the most reliable aggregate reflecting the performance of the financial system as a whole. The latter is especially true in the case of Tanzania, where the money supply accounted for up to about 80 % of the total financial assets of the country during 1967—80 (cf. Table 7.0).

Another aspect of the monetary expansion in Tanzania during 1966—80 that gives it special interest for analysis is that it might have been inflationary. This may be seen from Table 8.1, presenting the money supply nominal and real growth rates, together with the inflation rates during 1966—81.

From Table 8.1, it may be noted that during 1966—80, when the nominal growth rates of Tanzania's money supply—both narrowly defined (M1) and broadly defined (M2)—grew at soaring rates, the corresponding real growth rates declined.¹ Thus, while the nominal growth rates of both the M1 and M2 accelerated uninterruptedly, from about 16 % during 1966—69 to 26 % in 1978—81, the corresponding real growth rates fell from about 16 % to 5 %. In other words, the trends in the nominal and real money stocks imply that during 1966—81 there was an excess supply of, relative to demand for, nominal money in Tanzania.

This excess supply of money might explain the recorded acceleration in the

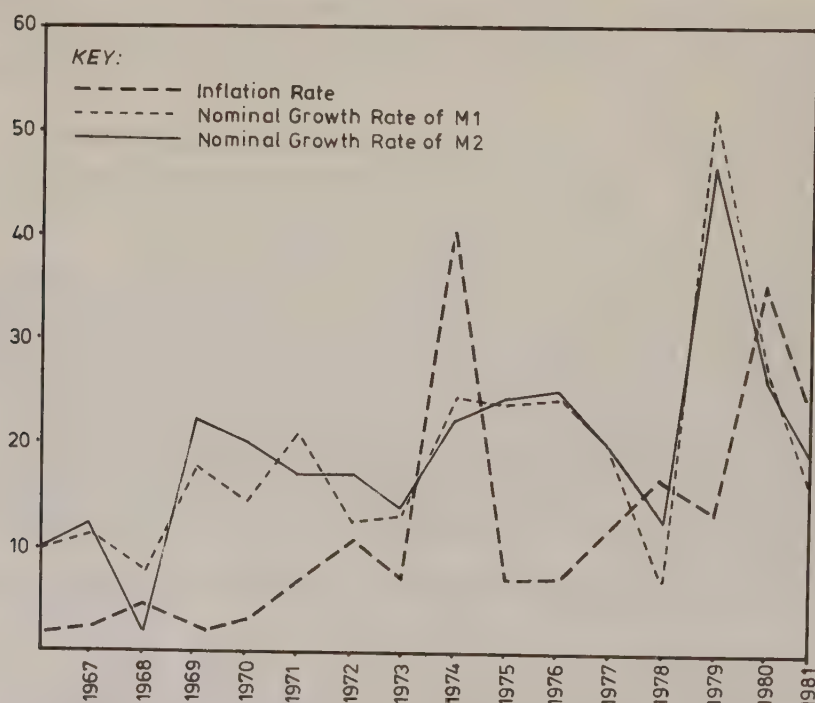
¹ Money supply is narrowly defined as M1 to include currency in circulation outside banks and non-government demand deposits, while it is broadly defined as M2 to include M1 plus time and saving deposits of the banking system.

Table 8.1. Tanzania: Inflation rates, nominal and Real Rates of Growth of M1 and M2. (Annual Averages, in %).

	1966-69	1970-73	1974-77	1978-81
Inflation Rate	2.9	6.6	15.9	20.3
Nominal Growth Rates:				
M1	16.4	18.2	22.8	26.5
M2	16.8	18.2	18.3	26.2
Real Growth Rates:				
M1	13.2	11.1	5.9	4.8
M2	13.6	11.6	2.3	4.0

Source: Adapted from Annex 8.1. Inflation rates have been calculated as changes in the National Consumer Price Index (NCPI), data of which was obtained from Bank of Tanzania: Economic and Operations Report, various issues.

Chart 8.1. Tanzania: Nominal Growth Rates of M1 and M2, and Inflation Rates During 1967-81 (in percentages).



Source: Adapted from BOT: Economic and Operations Report, Various Years.

inflation rate—from about 3 % during 1966—69 to 20 % in 1978—81.² The nominal growth rates of M1 and M2, together with the rates of inflation during 1967—81 are plotted in Chart 8.1.

Chart 8.1 suggests a more or less direct relation between monetary expansion and the rate of inflation in Tanzania. In this case, by explaining the money supply process, one is simultaneously able to explore the inflationary process—which is a fundamental policy issue.

In order to study the money supply process in Tanzania, I shall use the money multiplier framework, which is organized around the demand for, and supply of, high-powered money (defined below).

8.1 The Money Multiplier Framework

In the money multiplier context, changes in money supply are mainly determined by changes in the monetary base, or high-powered money (the terms are interchangeable).³ The latter is defined as the monetary liabilities of the central bank, comprising currency (notes and coins) and non-government deposits held by the central bank. The sources (supply) of the monetary base may be traced from the asset side of the central bank's balance sheet. Thus, looking at the BOT's balance sheet, one may identify the following types of monetary assets:

- i) *Net Foreign Assets (NFA)*: including the central bank's holdings of foreign exchange, SDRs, as well as securities of (or guaranteed by) foreign governments or international financial institutions (c.f. Article 53 of the Bank of Tanzania Act).
- ii) *Net Claims on Government (GB)*: representing the central bank's credit to the government, net of the governments deposits with the bank, and consisting mainly of a portfolio of government paper—treasury bills and bonds, as well as advances.
- iii) *Net lending to banks (BB)*: This is the central bank's credit to the commercial banks and other financial institutions, less their deposits with the Bank (see Table 5.9).
- iv) *Other Assets Net (O)*: including all other monetary assets, such as the net amount outstanding on the revaluation account (a special account, pro-

² Due to the presence of price controls, the inflation rates may be repressed.

³ Sometimes the term "reserve money" is also used interchangeably with base/high-powered money.

vided under Article 15(3) of the Bank of Tanzania Act, to which profits or losses from any revaluation of the Bank's net foreign assets or liabilities as a result of changes in the exchange value of the TZS are charged), items in process of collection (net), etc.

The monetary base may be seen to be identically equal to the sum of the above mentioned assets (Assets = Liabilities), viz:

$$B = NFA + GB + BB + O \dots \quad (1)$$

On the uses (demand) side, base money in the form of currency is partly held by the public (individuals) for effecting day-to-day transactions. The rest of the currency issued is held by banks as cash reserves. The amount of such reserves is usually determined by legal regulations and/or by the banks' own liquidity rules.

Denoting the amount of base money held by the public as C , and the bank reserves as R , then the supply (sources) of base money (B) must equal its demand (uses). Thus:

$$B = C + R \quad (2)$$

The banks' reserves may be regarded as the sum of the required (by law or by the banks' own liquidity rules)—denoted by RR , and the excess—denoted by ER , reserves. Here I assume that banks do not maintain excess reserves, so that equation (2) may simply be re-written as:

$$B = C + RR \quad (2')$$

Defining c as the currency to deposit ratio, and r as the required reserves to deposit ratio, then C and RR may be expressed in terms of deposits, thus:

$$C = c.D; \text{ and } RR = r.D \quad (3)$$

By substituting the expression (3) into (2'), we obtain an expression of the monetary base as a multiple of deposits:

$$B = (c+r).D \quad (4)$$

Thus:

$$D = B/(c+r) \quad (4')$$

The fundamental identity of the money multiplier framework says that the money stock (M) is a certain multiple (m) of the monetary base (B). Thus:

$$M = m.B \quad (5)$$

By using the narrow definition of money (M1), the money stock (M) may be expressed as currency (C) plus deposits (D);

$$M = C + D \quad (6)$$

Substituting $C = c.D$ into equation (6), we get:

$$M = (1 + c).D \quad (6')$$

Substituting D with the right hand side of (4') we obtain the expression for the multiple (m)—called the money multiplier—in terms of the currency and reserves to deposit ratios. Thus:

$$M = (1 + c)/((c + r)) \cdot B \quad (7)$$

and finally, putting (5), (7), and (1) together, we obtain:

$$M = (1 + c)/((c + r)) \cdot (NFA + GB + BB + O) = m.B \quad (5')$$

The relationships presented by the above equations suggest that monetary expansion (an increase in the quantity of money) may come about as a result of three main factors, viz:

- i) an increase in the monetary liabilities of the central bank,
- ii) a decrease in the commercial banks' reserve ratio (r), and
- iii) a decrease in the public's currency to deposit ratio (c).

As mentioned in Chapter 5, in Tanzania, changes in reserve requirements have not been used as a tool of monetary policy, especially after the introduction of annual financial planning in 1970/71. Thus, we remain with factors (i) and (ii) as the main explanations for the money supply behaviour in Tanzania during 1967—80.⁴

⁴ Most empirical studies have converged in concluding that the monetary base and the currency ratio are the main determinants of the money supply. See, for example, Harold Black (1975).

8.2 Analysis of Sources of Tanzania's Base Money During 1967—81

Table 8.1 presents the BOT's balance sheet, showing in detail the main sources and uses of funds by the central bank. It may be noted from the Table that, when net positions are taken (deducting assets from corresponding liability items or vice versa), currency in circulation constitutes the only major debit (sources) item on the BOT's balance sheet. This suggests that the monetary base is almost entirely composed of the currency in circulation. On the credit side, it may be seen that net foreign assets, net claims on the government, and net lending to banks constituted the main directions in which the BOT used its funds during 1967—81. The accumulation of the latter monetary assets may be seen as the source for the monetary liabilities (base money, mainly currency) of the bank.

From Table 8.2, we may proceed to analyse the sources of the monetary base in Tanzania. This is done in Table 8.3(a), summarizing the sources of the monetary base as reflected by the BOT's net asset portfolio, and Table 8.3(b), presenting the contributions of changes (flows) in the various types of monetary assets to the changes in the monetary base.⁵

The first point to be noted from Tables 8.3(a) and 8.3(b) is that during 1967—73, the monetary base was predominantly backed by foreign asset holdings, which at the same time formed its major source of supply. Thus, during the period, net foreign assets (NFA) accounted for over 70 % of the total monetary assets of the BOT, and contributed an average of about 78 % of the total annual change in the monetary base (see also Annex 8.3). The relatively strong foreign reserve position of the central bank during 1967—73 has at least three explanations:

- a) a reflection of the tradition of the currency board system from which the Bank of Tanzania took its course in 1966 (see chapter 3);
- b) an indication of a relatively good balance of payments out-turn (see Annex 2.1);
- c) absence of high domestic credit demand pressure on the part of the public and private sectors: this is partly reflected in the decline of the contribution of net claims on the government and net lending to banks to the changes in the monetary base during 1967—73 (see Table 8.3(b)).

The dominance of foreign assets in the portfolio of the central bank's monetary assets in the period 1967—73, suggests that the government had a breathing space, as it started out free of huge public debts.⁶

⁵ For more details of these figures, refer to Annexes 8.2 and 8.3

⁶ This is in line with the explanation offered by Green et. al. (1980), that during much of this period the limit on capital formation was the capacity to plan and implement projects, rather than the availability of domestic savings or external finance *per se*.

Table 8.2. BOT: A Simplified Balance Sheet, 1967—81. (End of Year figures, in TZS million).

Liabilities/Assets	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
I. Liabilit. (Sources)															
1. Deposits, total	6.6	146.8	71.7	9.2	12.4	28.7	54.5	44.9	56.8	45.0	68.8	37.3	283.6	65.1	231.2
of which:															
1.1 Non-government	1.6	49.0	5.6	5.5	10.7	26.1	44.3	30.0	37.3	34.6	58.0	34.8	279.6	64.4	229.3
1.2 Gov. Deposits	5.0	97.8	66.1	3.7	1.7	2.6	10.2	14.9	19.5	10.4	10.8	2.5	4.0	0.7	1.9
2. Currency															
Circulat.	539.2	568.3	650.3	861.0	1049.3	1279.5	1278.5	1608.6	1862.98	2214.9	2565.0	3143.5	4278.2	5522.9	6950.0
3. Foreign Liabilit.*	7.7	6.8	8.8	47.2	86.7	155.7	149.1	277.4	356.7	158.1	477.2	611.8	686.8	70.5	652.3
4. IMF	—	—	—	250.8	272.34	272.1	271.3	694.7	905.3	1213.2	1243.2	1149.8	1479.1	1870.4	1635.1
5. Other Liabilit.**	32.8	40.8	43.3	65.5	107.6	87.1	104.6	120.0	141.5	137.8	142.4	266.9	264.2	888.5	997.7
TOTAL															
LIABILITIES	586.3	762.7	774.1	1233.7	1528.3	1823.1	1858.0	2745.6	3323.2	3769.0	4496.6	5209.3	6991.9	9097.4	10466.3
II. Assets (Uses)															
6. Foreign Ass.															
(FA)*	405.4	519.4	534.9	410.8	375.6	776.9	956.2	389.7	545.7	934.9	2292.6	759.7	724.0	451.3	336.9
7. Claims on Gov.	64.1	31.8	148.3	416.2	638.0	554.6	507.2	1055.9	1368.1	1601.0	1311.0	2873.1	5042.3	6549.7	7990.0
8. Lending to Banks	53.6	82.0	34.0	71.0	163.0	136.0	—	180.0	764.0	796.0	73.0	842.0	234.0	290.0	466.9
9. IMF Quota	—	—	—	300.0	325.7	325.7	361.9	361.9	361.9	405.7	405.7	531.3	579.8	799.0	872.2
10. Other Assets***	63.6	129.5	56.9	35.7	26.0	29.9	32.7	758.1	283.5	31.4	414.3	203.1	411.8	1007.4	800.3
TOTAL ASSETS	586.3	762.7	774.1	1233.7	1528.3	1823.1	1858.0	2745.6	3323.2	3769.0	4496.6	5209.3	6991.9	9097.4	10466.3

Notes: * Includes allocation/use of SDRs (Special Drawing Rights).

** Includes debit balances on the Revaluation account, Capital and Reserves and Other Liabilities.

*** Includes Credit balances on the Revaluation account, items in process of collection premises and equipment, and other assets.

Source: BOT: Economic and Operations Report, various years.

*Table 8.3(a). The Source of Base Money in Tanzania: On Stock Basis.
(Average annual percentages of total Base Money).*

Source	1967-69	1970-73	1974-77	1978-81
1. Net Foreign Assets of the Central Bank (NFA)	96.6	70.1	41.4	24.0
2. Net Claims on Government (GB)	-1.8	30.6	39.8	70.6
3. Net Lending to Banks (BB)	1.6	3.7	22.2	6.2
4. Other Assets, Net (0)	3.6	-4.4	-3.4	-0.8
Total Monetary Assets of the Central Bank (Base Money)	100.0	100.0	100.0	100.0

Source: Adapted from Annex 8.2.

Sources	1967-69*	1970-73	1974-77	1978-81
1. Net Foreign Assets of the Central Bank (NFA)	45.1	94.7	-0.8	-53.3
2. Net Claims on Government (GB)	38.2	28.0	45.3	142.2
3. Net Lending to Banks (BB)	-8.4	-11.8	55.0	28.0
4. Other Assets, Net (0)	25.1	-10.9	0.5	-16.9
Total Change in the Money Base	100.0	100.0	100.0	100.0

Note: * Excludes the year 1969, with an exceptionally high rate of government borrowing from the central bank.

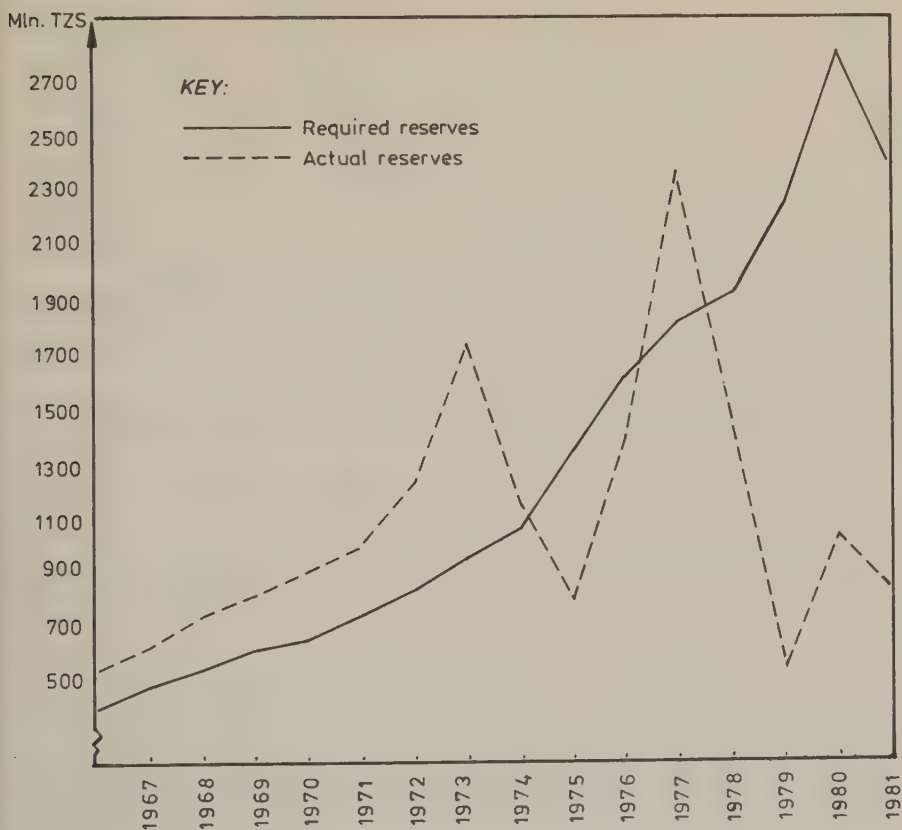
Source: Adapted from Annex 8.3.

While the large share of foreign assets in the total monetary assets of the central bank is partly a reflection of the requirement (effective up to 1978) to maintain a reserve of external assets at an aggregate amount of not less than the value of four months' imports as averaged for the last three preceding years (Section 53(1) of the Bank of Tanzania Act 1965), an excess over the required reserves (which were relatively high compared to the developing country standards), indicates a lack of an excess demand pressure on foreign exchange. Chart 8.2 gives a comparison of the reserves as required by law against actual.

Chart 8.2 indicates that during 1967-73, the legal requirement imposed on the foreign reserves by the 1965 version of the Bank of Tanzania Act was not a factor constraining credit extension to the domestic sectors. During the period, the foreign reserves were maintained at a much higher level than required, reaching as much as 194 % of the required limit in 1973 (see also Annex 8.5).

The second point notable from Tables 8.3(a) and 8.3(b) is that during 1974-81, net foreign assets declined dramatically as a source of the monetary base. As a result, by 1978-81, NFA accounted for only 24 % of the central bank's total monetary assets, and contributed negatively to the expansion of the monetary base (by some 53 %). On the other hand, net claims on the govern-

Chart 8.2. Central Bank Required and Actual Reserves (1967—81) (in million TZS).



Source: Adapted from Annex 8.5.

ment grew rapidly during 1974—81 to become the major source of the base money, contributing an average of over 90 % of the total sources of monetary base during 1974—81. This was accompanied by a general rise in the central bank net lending to the commercial banks.

Of special interest is the increase of government borrowing from the central bank during 1974—81. This may be explained by studying the causes for the public sector deficits and their financing during 1966—81.

8.3 The Public Sector Deficits and Their Financing

It may be observed from Annex 8.3 that the public sector as a whole has been running current account deficits from the year 1966/67.⁷ As a result, the public sector has to rely on borrowing from various sources (domestic and foreign) in order to finance its deficits on current and capital accounts.

In the discussion that follows, I shall refer to the sum of the deficit (or difference, in case of surplus) on current budget and the capital expenditure of the public sector, less capital transfers to that sector, as the total public sector financing requirement (TPSFR). It is composed of two main elements:

1. the budgetary financing requirement of the government (BFR), referring to the sum of the deficit on current account and development/capital expenditure, less capital transfers to the government;
2. the parastatal financing requirement (PFR), referring to the same sum with respect to parastatal enterprises.

Table 8.4 presents the trends in the TPSFR, BFR and PFR both in nominal terms and as percentages of the monetary Gross Domestic Product (GDP) for a selected number of years during 1963—80.

The significance of the public sector financing requirements for the operation of the Tanzania's financial system may be judged from the ratios of the TPSFR (and its components) to the monetary GDP. Thus, according to Table 8.4, the ratio of the TPSFR to monetary GDP rose sharply from about 2 % in 1963/64 to 38 % in 1976/77. The increase in this ratio was sharpest during 1966—70, when it rose from about 9 % to 25 %, reflecting the rapid expansion of the public sector due to the nationalizations that followed the Arusha Declaration of 1967. The bulk of the increase in the TPSFR over the period up to 1976/77 was mainly due to PFR. As a result, the ratio of PFR to monetary GDP rose faster, from less than 1 % in 1963/64 to about 25 % in 1976/77, compared with the ratio of the BFR to the monetary GDP, which rose from about 1 % to only 13 % during the same period. However, during 1977—80 the ratio of the BFR to monetary GDP rose sharply, from about 13 % to 24 %.⁸ This rise was due

⁷ The definition of public sector used here is similar to the one used in the Tanzania's national Accounts, and includes the central government, the parastatals, and other official entities (such as the Ruling Party, CCM), see Wangwe (1983, p. 72).

⁸ This was a reflection of two main factors: a recurrent budget surplus "boom" of 1977—78 (cf. Table 8.7), which induced high levels of government expenditure—manifesting the "Please Effect", and the outburst of the Iddi Amin War in the second half of 1979. As a result of the former factor, large government budget deficits followed the shrink in the government revenue base, resulting from the decline in world market commodity prices and of the GDP after 1978. For a more discussion of this, see Green et. al. (1980).

Table 8.4. Trends in TPSFR, BFR and Parastatal Financing Requirement (PFR) as Shares of Monetary GDP, Selected Years. (In Millions of TZS, except where specified as %).

	1963/64	1966/67	1969/70	1972/73	1976/77	1979/80
1. Monetary GDP (at current prices)	3824	4631	5860	8279	17298	21735
2. TPSFR	88	426	1486	2366	6497	—
3. BFR	52	191	613	759	2264	5111
4. PFR*	36	235	873	1607	4233	—
5. TPSFR as % of (1)	2.3	9.2	25.4	28.6	37.6	—
6. BFR as % of (1)	1.4	4.1	10.5	9.2	13.1	23.5
7. PFR as % of (1)	0.9	5.1	14.9	19.4	24.5	—

Notes: * The PFR figure here does not tally with that of Table 8.5 because it has been calculated on cash basis; Not Available.

Source: Adapted from Annex 8.12 of the Appendix. GDP figures are from the National Accounts of Tanzania.

to a sharp increase in the deficits on the recurrent budget of the government, accounting for up to 46.6 % and 53.6 % of the total BFR in 1978/79 and 1983/84 respectively.

8.3.1 The Financing of the TPSFR

In line with the discussion above, Table 8.5 shows that the share of the PFR in the TPSFR rose uninterruptedly from about 41 % in 1963/64 to 65 % in 1976/77, while that of BFR declined correspondingly. It is also evident from the Table that the contribution of domestic sources to the financing of the TPSFR increased substantially, from about 42 % in 1963/64 to 73 % in 1976/77. This implies, among other things, that the domestic financial institutions accommodated an increasing share of the TPSFR. The effect of increased public sector borrowing on the money supply and on other domestic financial assets may be studied by taking a more disaggregated view of the TPSFR.

A detailed analysis of the TPSFR can best be undertaken by studying the parastatals and the central government separately. This is essentially due to the differences in the methods in which the two types of institutions finance their needs.⁹ Moreover, we assume that a separate analysis will avoid the confusion that may arise in tracing the interrelations between the budget deficits of the parastatals and that of the central government.

⁹ See sub-section 8.3.2.

Table 8.5. The Components of the TPSFR and Their Financing (Selected Years, 1963/64—1979/80). (Percentages, except where specified).

	1963/64	1966/67	1969/70	1972/73	1976/77
1. TPSFR, million TZS	88	426	1486	2366	6497
of which:					
1.1 BFR	59.1	44.8	41.3	31.8	34.8
1.2 PFR	40.9	55.2	58.7	68.2	65.2
	100.0	100.0	100.0	100.0	100.0
2. Financed From:					
2.1 Domestic Sources	41.7	64.3	89.1	73.0	73.3
2.2 Foreign Sources	58.3	35.7	10.9	27.0	26.7

Source: Adapted from Annex 8.12.

8.3.2 The Financing of the Parastatal Deficits

Annex 8.9 shows that during 1966—77, the financing requirements of the parastatal sector as a whole were mainly for capital formation. These requirements were met from own funds (retained profits and depreciation), and outside sources, including loans and grants from the Tanzania government and from the rest of the world, as well as borrowing from the domestic financial institutions.

According to Table 8.6, the reliance of the parastatal sector on outside finance (as contrasted with internal or own finance) increased tremendously from about 40 % during 1966—69 to become the only source of financing during 1974—77. As far as outside sources of financing are concerned, borrowing from domestic financial institutions accommodated much of the increase in financial requirements. As a result, the relative share of borrowing from domestic financial institutions in the total requirements of outside funds by the parastatals more than doubled, rising from an average of about 33 % in 1966—69 to about 71 % in 1974—77. During the same period, the relative contributions of the government, and of foreign sources to the requirements of outside funds by the parastatals declined, but not in absolute terms (see Annex 8.9).

The absolute and relative increase in borrowing from the domestic financial institutions—mainly the commercial and the development banks—reflect the privileged position of the parastatal sector in the allocation of financial resources, especially after the nationalization of the financial system in 1967, and the introduction of annual financial planning in 1970/71 (see Chapter 5).

From the foregoing analysis, it is evident that the growth of the parastatal sector in Tanzania has affected the working of the monetary system in at least two ways:

Table 8.6. Sources of Parastatal Financing (in percentages).

Annual averages	1966-69	1970-73	1974-77
1. Total Financial Requirement	100.0	100.0	100.0
Financed by:			
1.1 Own Sources*	59.3	10.8	-15.7**
1.2 Outside Resources	40.7	89.2	115.7
2. Outside Financing Requirement	100.0	100.0	100.0
of which:			
2.1 Loans and Grants from Tanzania Government	40.7	24.2	21.4
2.2 Borrowing from domestic financial institutions	32.6	55.4	70.6
2.3 External Loans and Grants	26.7	20.4	8.0

Notes: * Includes retained profits, depreciation, and use of cash balances.

** The negative figure implies that the sector was in fact accumulating financial assets/cash at the expense of outside sources of finance. This is plausible granted that financial institutions are included in the sector.

Source: Adapted from Annex 8.9.

- a) by increasing the pressure on the government financial requirement; and
- b) by increasing the pressure on demand for loanable funds available through the formal financial sector.

8.3.3 The Causes of the Government Budgetary Deficits

As seen from Table 8.6 (and the Annex 8.10), the increase in Tanzania's BFR recorded during 1966—80 was mainly due to the rapid rise in the government's development budget. The nominal value of the development expenditure rose almost 15-fold during 1966—80, recording an average real growth of about 14 % per annum.¹⁰ In the period up to 1976/77, the development budget accounted for more than 90 % of the BFR, while current budget deficits took hardly 5 % of the BFR. However, in the period following the current budget surplus boom of 1977/78 and the out-burst of the Idi Amin was in 1979, relatively large deficits have been registered on the government's current budget. As a result, current budget deficits increased their average share in the BFR to about 30 % during 1978—81.

A comparison of the Annex 8.9 and Table 8.7 illustrates the connection between the parastatal sector expansion and the BFR. In particular, it may be noted that the government's loans and grants to the parastatals—obtainable from the development budget—accounted for about one-third of the BFR during 1966—77.

¹⁰ The 1966/67 figure has been deflated by the Retail Price Index and the 1980/81 figure by the National Consumer Price Index, both of 1970 base.

Table 8.7. Analysis of Government Budgetary Financing Requirement (1966—81). (Nominal values in TZS million).
(Calculated from end of June.)

	1966/67	1967/68	1968/69	1969/70	1970/71	1971/72	1972/73	1973/74	1974/75	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81
Uses of Financing Requirement															
1. Deficit (surplus on current budget)	(37.0)	(56.9)	(62.1)	31.6	34.6	21.4	36.7	(482.0)	18.8	(250.0)	88.3	(867.1)	1199.2	1316.4	1916.0
2. Development Budget Deficit	294.4	344.1	460.5	610.5	829.2	772.8	948.7	1642.0	2225.0	2188.0	2763.6	3877.4	4756.8	4947.0	4327.8
3. Less: transfer special funds net of repayments*	(66.0)	(37.5)	(13.1)	(29.5)	(11.6)	(33.6)	(226.7)	(396.1)	(378.7)	(469.8)	(588.2)	(1175.5)	(1264.6)	(1152.9)	(1358.6)
Budgetary Financing Requirement (BFR)	191.4	249.7	385.3	612.6	852.2	760.6	758.7	763.9	1865.1	1468.2	2263.7	1834.8	4691.4	5110.5	4885.2
Sources of Financing BFR															
4. External Borrowing	19.9	81.5	122.0	121.5	258.3	347.4	251.0	282.6	661.0	564.0	776.6	819.8	819.8	1268.0	687.0
5. Dom. Borrowing (Tot.)	38.5	191.9	175.6	480.4	582.7	413.3	497.9	476.9	1202.0	1281.4	1495.2	1002.5	3875.3	3839.3	4196.9
5.1 From Bank of Tanzania	1.9	18.5	—13.2	184.5	200.5	121.7	122.1	332.4	291.3	301.3	—6.3	327.9	2238.8	1116.3	1538.3
5.2 From Commercial Banks	17.0	20.9	98.9	5.8	77.9	162.2	117.3	—29.6	565.0	790.0	—68.6	76.7	721.0	1733.3	1413.9
Bank Borrowing (Tot.)	18.9	39.4	85.7	190.3	278.4	283.9	—4.8	302.8	856.3	1091.3	—74.9	404.6	2959.8	2849.6	2952.2
5.3 Non-Bank Borrowing (Tot.)	19.6	152.5	89.9	290.1	304.3	129.4	382.2	174.1	345.7	190.1	1570.1	597.9	915.5	989.7	1244.7
6. Use of Cash Balances	33.5	—23.7	87.7	10.7	11.2	—0.1	3.8	4.4	2.1	3.09	—8.1	12.5	—3.7	3.2	1.3

Notes: * Mainly foreign grants.

Source: Adapted from Annex 8.10.

Table 8.7 shows that, especially after 1972/73, capital transfers (dominated by grants from foreign sources) reduced the magnitude of the BFR by an average of about 25 % during 1973—80.¹¹

8.3.4 The Financing of the BFR

As seen from Table 8.7, the BFR is financed by three sources: foreign loans, domestic borrowing, and use of accumulated cash balances.

According to Table 8.8, prior to 1966/67, foreign borrowing was a major source of financing the BFR, accounting for an average of about 53 % of the BFR during 1963—67. After 1966/67, the share of BFR financed by foreign borrowing declined to slightly less than 20 % during 1978—81. In absolute terms, however, foreign borrowing by the government increased significantly, and the ratio of foreign loans to monetary GDP rose from an average of about 2 % during 1963—67 to 5 % in 1979—81.

Domestic borrowing by the government rose, in nominal terms, more than a *hundred* times between 1966/67 and 1980/81. In real terms, this amounted to an average annual growth of about 34 % during 1967—81.¹²

The dramatic increase in domestic government borrowing after 1966/67 may be explained by two main factors:

- a) the shift of government policy from emphasis on external resource mobilization, as envisaged in the country's First Five Year Plan (FFYP) 1964—69, to a policy of "self-reliance", based on domestic resource mobilization along the lines sketched in the Arusha Declaration of 1967;¹³
- b) the creation of a national monetary authority (central bank) in 1966, and the nationalization of the financial system in 1967, both of which provided an easy resort for financing the government.

8.3.5 Sources of Government's Domestic Borrowing

In Tables 8.7 and 8.9 I have distinguished two main sources of domestic borrowing by the government:

- 1) the banking system, comprising the central bank (Bank of Tanzania) and the commercial bank (the National Bank of Commerce, NBC, in case of Mainland Tanzania); and

¹¹ Foreign transfers to the government declined sharply from 1966/67 up to 1971/72, probably reflecting the political uncertainties after the nationalizations that followed the adoption of the Arusha Declaration.

¹² The figures for 1966/67 and 1980/81 have been deflated by the Retail Price and the National Consumer Price Indices (1970 = 1.00) respectively.

¹³ For a brief discussion of this shift in policy, see, Rwegasira (1976), Kuuya (1975), Green et al (1980).

Table 8.8. The Ratios of Foreign Borrowing to BFR and Monetary GDP (%).
Annual averages

	1963-67	1968-73	1974-78	1979-81
Ratio of Foreign Borrowing to:				
a) BFR	52.9	35.4*	38.0	18.9
b) Monetary GDPL	2.0	2.9	4.3	4.9

Note: * excludes the year 1969/70 with abnormally low figure of 19.8 %.

Sources: Foreign borrowing figures are from Table 8.5, while monetary GDP data was from National Accounts of Tanzania, various issues.

Table 8.9. Sources of Domestic Government Borrowing, 1966—81. (Average annual shares, in percentages).

Sources	1966-69	1970-73	1974-77	1978-81
Total Domestic Borrowing	100.0	100.0	100.0	100.0
of which:				
1. Central Bank	2.3	19.4	29.3	39.1
2. Commercial Banks	37.1	19.4	24.5	26.3
Banking System, Total	39.4	38.8	53.8	65.4
3. Non-bank Institutions	60.6	61.2	46.3	34.6

Source: Adapted from Annex 8.10.

Table 8.10. Composition of Outstanding Bank Credit by Domestic Sectors, 1966—81. (Annual Averages, in percentages).

	1966-69	1970-73	1974-77	1978-81
Total Outstanding Bank Credit to Domestic Sectors	100.0	100.0	100.0	100.0
of which:				
Public Sector	25.2	69.3	87.9	92.2
Private Sector	74.8	30.7	12.1	7.8

Source: Computed from Annex 8.6.

- 2) non-bank institutions, including the contractual saving institutions, such as the National Provident Fund (NPF), the Parastatal Pension Scheme (PPS), the Insurance Corporation (NIC), the Post Office Savings Bank (POSB), as well as other public and private institutions.

The extent to which the government has relied on each of the main sources of domestic borrowing is presented in Table 8.9.

It is evident from Table 8.9 that the government relied increasingly on the banking system, especially the central bank, as a source of domestic borrowing

during 1966—81. As a result, the share of the banking system in the total domestic borrowing by the government rose from an average of about 39 % during 1966—69 to about 65 % in 1978—81. This increase was mainly due to the central bank, of which contribution to the total domestic borrowing rose sharply from an average of about 2 % in 1966—69 to 39 % in 1978—81. During 1974—81, mobilization of savings through the non-bank institutions could not keep pace with the growth of government borrowing, with the result that the contribution of non-bank institutions to total domestic borrowing by the government declined gradually from about 60 % during 1966—73 to 35 % in 1978—81.

The trends in the public sector borrowing discussed above have had a direct bearing on the changes in the sources of the monetary base by composition, as well as on the monetary system as a whole. Thus, for example, as a result of the public sector operations vis a vis the monetary system described in this section, the public and the private sectors have, in the course of the period 1966—81, exchanged positions in their issue of liabilities to the monetary system (see Table 8.10).

According to Table 8.10, during 1966—69 claims of the central and commercial banks (i.e. the monetary system) on the public sector accounted for only about a quarter of the total outstanding domestic claims, while the private sector accounted for the rest (about 75 %). By 1978—81, however, the public sector already accounted for about 92 % of the total claims, while the private sector remained with only about 8 %. This is one evidence for crowding-out in Tanzania during 1966—81.

8.3.6 The Public Sector Deficits and the Monetary Base: A Resumé

Putting together the information provided in Tables 8.3 through 8.10 above, one may safely conclude that during 1966—81, increased total public sector deficits, and hence TPSFR, forced the government to run more and more to the banking system—particularly the central bank—for borrowing. One result of this was to increase the monetary base, and the share in it of the net claims on the government, at a relatively fast rate. The second effect, related with the first, was to increase the money supply, both by bulging the monetary base and commercial bank deposits. More specifically speaking, the increase in the money supply in any given year may, with some simplifying assumptions, be regarded as the sum of the TPSFR and the increase in bank lending to the private sector minus public sector borrowing from the private and foreign sectors. What we have seen, in the case of Tanzania, is that commercial bank credit to the private sector declined drastically, while public sector borrowing from the private and foreign sources more or less stagnated. On the overall, therefore,

the increase in the money supply may almost totally be attributed to the TPSFR.

On the other hand, it has been shown above that the TPSFR increased mainly on the account of the need to finance the parastatal sector up to around 1977, and on account of recurrent budget deficits thereafter.

8.4 The Money Supply and the Money Multiplier

The analysis of the monetary base in the previous section suggested that it increased and, *ceteris paribus*, the money supply would have increased as well. To have this effect, the main condition that is required to have remained equal is the money multiplier (m).¹⁴ In this section I discuss the behaviour of the money multiplier in Tanzania during the 1970s.¹⁵ However, as mentioned earlier, in Tanzania, the money multiplier is mainly determined by the currency to deposit ratio.

8.4.1 The Currency to Deposit Ratio

One of the striking features of the composition of Tanzania's money supply is the high currency to deposit ratio, typical to most African countries.¹⁶ As seen from Table 8.11, during 1970—81, the Tanzania's currency to deposit ratio—which, according to the model in section 8.1, is inversely related to the money multiplier—declined from an average of about 0.78 in 1970—73 to 0.57 in 1978—81.¹⁷

The main factors explaining the fall in the currency to deposit ratio in Tanzania during 1970—81 were:

- i) an increase in the demand for money, reflected by a fall of the income velocity of money from an average of about 3.3 in 1970—73 to about 2.2 in 1978—81;¹⁸

¹⁴ See the model in section 8.1, especially equation (5).

¹⁵ I omit the period prior to 1970 to unreliability of the money supply figures. This unreliability is due to the fact that the BOT had little knowledge of currency in circulation at the time when the Currency Board's notes and coins co-existed with the separate national currencies in East Africa. For more discussion of this point, see, for example, Rwegasira (1976).

¹⁶ See Arowolo (1971). Edward Arowolo's interesting calculation of these ratios from 30 countries indicate that the share of demand deposits in M1 is about 30—45 % in most African countries.

¹⁷ The level reached during 1978—81 was still quite high when compared with that of the neighbouring Kenya, which was of the order of 0.20—0.25 during the same period.

The Kenyan figure has been obtained from, *Financial Journal*, 1981 vol. 2 no. 1, published by the African Centre for Monetary Studies.

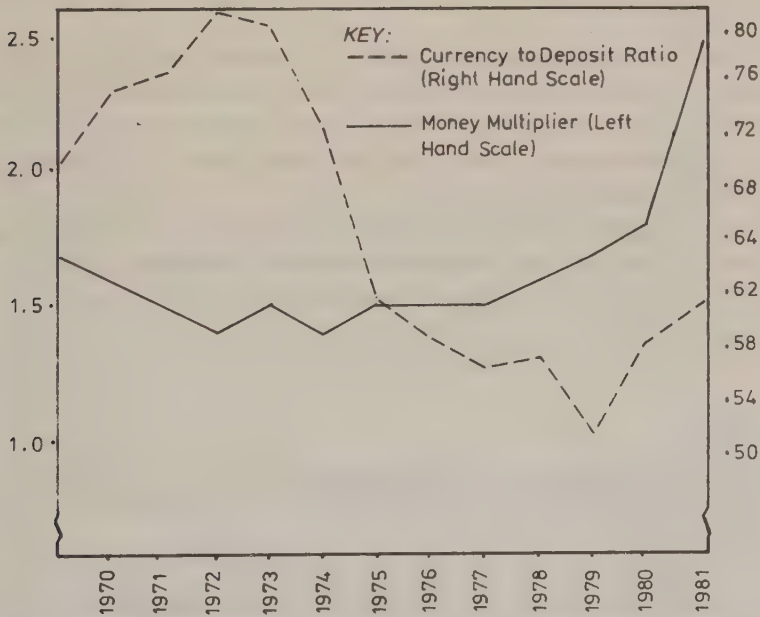
¹⁸ In absence of a well developed network of banking offices, a fall in the income velocity of

Table 8.11. The Currency to Deposit Ratio, Velocity of Money, and the Money Multiplier in Tanzania during 1970—81 (percent).

	1970-73	1974-77	1978-81
1. Currency to Deposit Ratio	0.78	0.62	0.57
2. Velocity of Money	3.30	2.90	2.20
3. Money Multiplier	1.5	1.5	1.9

Source: Adapted from Annex 8.7.

Chart 8.3. Tanzania: The Money Multiplier and the Currency to Deposit Ratio Plotted against Time, 1970—81.



Source: Adapted from Annex 8.7.

money implies lower transactions and transport costs for those who hold money balances in form of deposits. Thus, the share of deposits in money balances tends to increase, relative to currency, as the velocity declines.

In an equilibrium context, however, the relation between the currency to deposit ration and the money multiplier should be conceived as follows: An increase in the currency to deposit ratio reduced the multiplier, which in turn leads to a decline in the money supply. The latter is followed by an increase in interest rates, which reduces the demand for money, thereby raising the income velocity of money.

- ii) in connection with (i) above, the expansion of the network of banking offices and agencies to previously “neglected” suburban/rural areas after the nationalization of the banking system in 1967 (see Chapter 6);
- iii) the change in the ownership structure of the economy, characterized by an increase in the share of public enterprises, of which constitutions provide for limited amounts of payments that may be made in cash, and require a bulk of payments to be made by cheque;
- iv) “money deepening” or the increased use of money in already monetized sectors—as opposed to “money widening” (which is the expansion of the monetary sector).

The former phenomenon is likely to be associated with more holdings of deposits than currency, because it involves clients with more advanced banking habits (see Porter (1966)). “Money deepening” in Tanzania, especially after 1974, is evidenced by the increase in the share of the subsistence sector from about 28 % in 1974 to about 40 % in 1980 (see Chapter 2).

- v) The retrogression in the development of non-bank financial institutions—including, among others, the development banks, insurance companies, pension schemes and cooperative savings schemes (see chapter 9)—resulting in a boosted demand for commercial bank services, and hence more holdings of demand deposits.

In line with the theoretical expectations, the fall in the currency to deposit ratio was associated with an increase in the money multiplier, from about 1.5 during 1970—77 to 1.9 in 1978—81 (see also Chart 8.3).

8.5 Causes of Monetary Expansion in Tanzania During 1967—81

In analogy with the central bank’s balance sheet, the commercial banks do also have net claims on the foreign sector, net claims on the government, net credit to non-government domestic sectors, as well as other assets (net), backing the money they issue—referred to as “bank” money (mainly demand deposits). In effect then, the sources of the monetary base and of bank money are essentially the same, and the consolidated balance sheet of the central bank and the commercial banks—forming the monetary system, or banking system proper—gives the total money supply on the liabilities side and its sources on its asset side.

Table 8.12 shows the growth in the money supply broadly defined (M2) to include quasi-money (savings and time deposits of commercial banks), as well

Table 8.12. Tanzania: Estimates for the Inflation Rates and Contributions of Various Sources to Growth in Monetary Base, 1967-81. (Stocks are given as end of Year positions, Values are in TZS million).

YEARS	% Change in NCPI	Changes in value	M2 in %	Money Multiplier (m)	Monetary Base (B)	% Change in Monetary Base	Change in NFA	Change in GB	Change in BB	Change in 0
1	2	3	4	5	6	7	8	9	10	11
1967	2.2			2.8	540.8					
1968	4.4	240.7	15.6	2.9	623.8	15.3	6.6	1.2	4.5	3.0
1969	2.1	95.2	6.4	2.9	656.7	5.3	1.7	2.6	2.7	-1.7
1970	3.1	342.2	18.2	2.6	867.3	32.1	-5.3	11.2	24.2	2.0
1971	6.9	481.9	21.7	2.5	1060.1	22.2	7.6	11.4	8.6	-5.4
1972	10.9	587.7	22.4	2.4	1305.1	23.1	23.6	1.5	2.2	-4.2
1973	7.1	48.1	1.6	2.8	1322.4	1.3	0.6	0.2	0.6	-0.1
1974	40.5	840.1	23.0	2.7	1633.5	23.5	-20.3	24.3	31.3	-11.8
1975	7.1	753.1	16.9	2.9	1893.2	15.9	0.7	11.1	6.6	-2.5
1976	7.2	1080.4	19.5	3.1	2241.8	18.4	5.4	13.4	4.3	-4.7
1977	12.0	1210.6	17.4	3.2	2620.1	16.9	12.3	-4.1	8.7	-0.1
1978	16.9	1657.4	19.9	3.0	3172.5	21.1	-43.5	34.5	33.3	-3.1
1979	13.2	3727.0	39.7	3.0	4412.7	39.1	1.7	29.8	6.0	1.6
1980	36.0	3197.6	23.2	3.1	5444.2	23.4	4.9	18.5	3.9	-3.9
1981	25.6	4603.5	26.3	2.9	7032.6	29.2	-3.2	27.1	10.4	-5.1

Notes: * NFA stands for Net Foreign Assets, GB for Net Claims on the Government by the banking system, BB for Net Domestic Lending to the non-central government sectors by the banks, and O for Other Monetary Assets (Net) of the banking system (including net amount on the revaluation account of BOT, items in process of collection, etc.).

Source: Adapted from BOT: Economic and Operations Report, Various Years.

as the main factors that might have contributed to its growth—the money multiplier and the monetary base.

Comparing the nominal growth rates of the M2 (column 4 of Table 8.12) with the inflation rate, approximated by the changes in the NCPI (column 2), it may be noted that, with the exception of 1973–74 and 1980, the money stock in Tanzania grew both nominally and in real terms. The increase in the money supply (M2) was due to the rise in the money multiplier, especially after 1971 (column 5), and mainly to the dramatic increase in the monetary base (column 7). The factors underlying the increase in the money multiplier and the monetary base have been discussed above. Nevertheless, the last four columns of Table 8.12, presenting the contribution of changes in net foreign assets, net claims on government, net lending to non-central government domestic sectors, and net other assets to the recorded increase in high-powered money, do at the same time suggest the factors that were responsible for the increase in the money supply.

From the last four columns of the table, it is evident that, with the exception of three out of the thirteen years—1968, 1972 and 1977, when increases in net foreign assets formed the main source of growth in the money stock, domestic credit formation (increase in the banking system's claims on the government and other domestic sectors) has been the primary source of the recorded expansion in the money supply. In this respect, in the period up to 1974, net claims on non-government domestic sectors (including the parastatal and the private sectors of the economy) dominated the recorded increase in money supply.

Thus, the average percentage contribution of the non-government domestic sectors to the money base expansion during 1967–73 was about 42 % per annum compared with an average contribution of about 28 % by increase in net claims on government. However, in the period after 1974, with the exception of 1977, increases in net claims on the government were persistently the main causes of monetary expansion. Thus, increases in the net claims of the banking system on the government contributed an average of about 80 % to the registered increase in the monetary base during 1974–80.

During the same period, changes in the banks' net claims on the other domestic sectors accounted for an average of about 60 % of the increase in the high-powered money. Changes in net foreign assets, and other assets (net), had contractionary effects, each accounting for about 20 %, of the change in the monetary base.

As far as the net foreign assets are concerned, the fact that they contracted money supply during 1974–81 implies a radical shift, when compared with 1967–73. During 1967–73 (excluding 1970), changes in net foreign assets accounted for a relatively large proportion in the total increase of the monetary base—averaging about 40 %. However, in the period after 1973, the general trend in the net foreign assets as a source of the monetary expansion has been

very much influenced by the sharp deterioration in the current account of the balance of payments in 1974 and 1978.¹⁹ With the exception of 1977, changes in net foreign assets accounted for only a small part of shares in the growth of money supply during the years 1974—80, and had contradictory effects of large magnitudes in 1974 and 1978.

Given the shift of the main source of money supply from net foreign assets during 1967—73, to government deficits during 1974—81, it is possible to postulate a higher inflationary impact of the money supply growth during 1974—80 than in the preceding period. This is because, although the primary monetary effect of increases in net foreign assets are the same as those of increases in net claims on the government or on the other domestic sectors, increases in the former represent a possibility for additional real resources (through imports), while the latter do not. As a result, increases in domestic credit will tend to generate inflationary pressures through both primary and secondary monetary expansion, but increases in net foreign assets influence monetary expansion only through the secondary expansion. This argument is supported by the inflationary experience of Tanzania (see Chapter 2).

Finally, recalling that bank credit to non-central government sectors was dominated by the parastatal sector, the discussion in this section further substantiates the conclusion that monetary expansion in Tanzania, particularly in the 1970s, was mainly due to the expansion of the public sector.

8.6 The Money Supply and the Exchange Rate

Related with the rate of monetary expansion in Tanzania, especially after 1978, is the overvaluation of the Tanzanian shilling (TZS). An overvaluation of a currency at the time when net foreign assets are being depleted tends to keep the rate of monetary contraction (implied by the fall in net foreign assets) below what it would have been under normal circumstances. The opposite would be true in the case of domestic currency undervaluation.

Overvaluation of the TZS was a direct result of the exchange controls (introduced from 1965), coupled with import licensing (from 1970).²⁰

In this section, I intend to show that the TZS has been overvalued, especially from the second half of 1970s. For this purpose, the notion of effective exchange rate will be used.

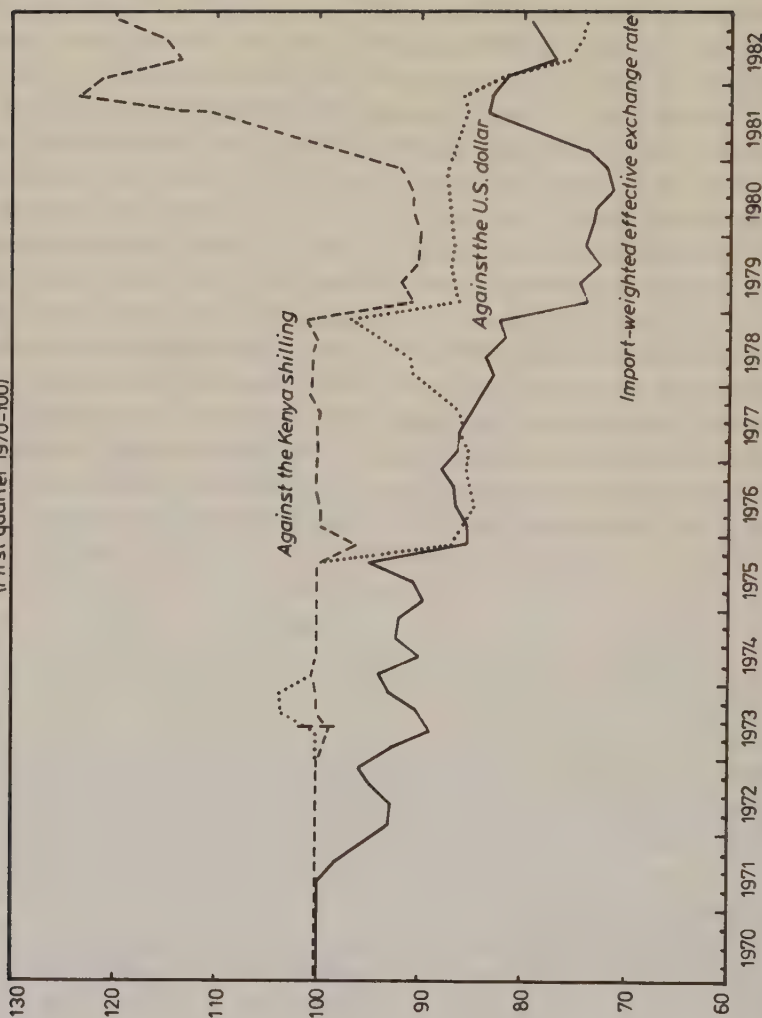
¹⁹ Cf. Annex 2.1.

²⁰ Cf. Chapters 4 and 5. Where the exchange rates are market determined, overvaluation or undervaluation of a currency becomes out of context.

TANZANIA

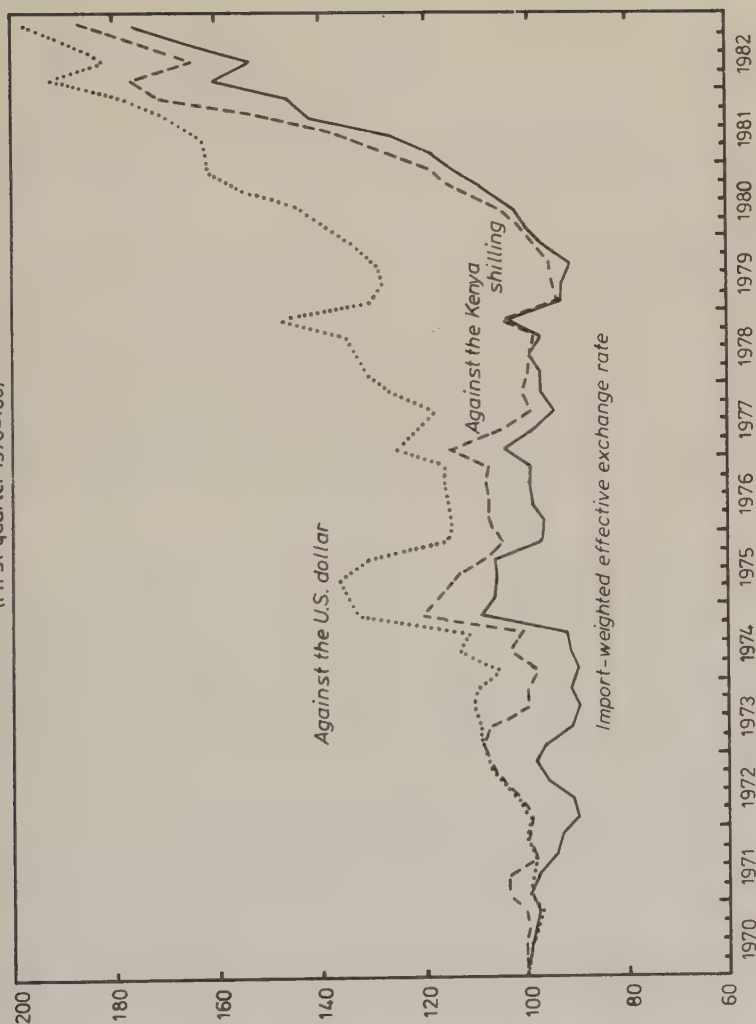
NOMINAL EXCHANGE RATES, 1970-82¹

(First quarter 1970=100)



¹ An increase in the index signifies an appreciation.
Source: Adapted from International Financial Statistics. IMF

TANZANIA
REAL EXCHANGE RATES, 1970-82¹
(First quarter 1970=100)



¹ An increase in the index signifies an appreciation.

Source: Adapted from International Financial Statistics, IMF.

8.6.1 The Concept of Effective Exchange Rate:

In a world of floating currencies, a change in the exchange rate of one of the currencies is determined by the weighted average of changes in the other currencies. Such an average is referred to as the *effective exchange rate index* of the given currency. The index may be expressed in nominal or in real terms.

In calculating the effective exchange rate, the weights applied represent the comparative importance to the domestic economy of each foreign country's currency of which changes will affect the value of the home currency.²¹

The index is calculated at a chosen base year, so that changes in it reflect appreciation or depreciation of the specific currency vis a vis a multitude of foreign currencies related to it.

Chart 8.4. shows the nominal exchange rates of the TZS against the Kenya shilling (KES), and the US dollar and the import-weighted effective exchange rate with the year 1970 as base. According to the chart, the effective import-weighted exchange rate of the TZS depreciated slightly during the whole period 1970—78, by some 16 %. The changes of the TZS against the KES (note that Kenya was an important, if not a major, source of Tanzania's imports before the break-up of the East African Community in 1977) were insignificant during 1970—78; while the rate against the USD was more or less stable, apart from the 15 % devaluation against the USD made in 1975.

Nevertheless, following the 10 % devaluation against the SDR in 1979, the nominal import-weighted effective index depreciated by about 7 %, and then gradually appreciated by more or less the same points in 1980/81. The exchange rate index against the USD depreciated slightly as the result of the 1979 devaluation and then maintained a level of about 15 % below 1970. As for the rate against the KES, there was an immediate depreciation of about 7 %, and at the end of 1980 a dramatic appreciation of the TZS by about 30 % against the KES occurred.

Chart 8.5 shows the real exchange rates corresponding to the nominal rates given in chart 8.4, i.e. against the KES, the USD and the import-weighted effective rate. Real exchange rates should be understood as the nominal ones adjusted for the relative price indices of the domestic economy vis a vis the price indices of its foreign partners. Thus, given the nominal rate of exchange, a higher rate of inflation in Tanzania than in Kenya, or United States will imply

²¹ Several possibilities exist in choosing weights for calculating the effective exchange rate index. One may use partner countries' shares in the home country's imports to obtain what is known as an effective import-weighted index; or use partner countries' shares in home country exports to obtain the so-called effective export-weighted index. Total bilateral trade flows, or the partners countries' shares in global trade, may also be used as weights in calculating the indices. For more discussion of this, see, for example, Kreinin (1979, Ch. 3).

an appreciation of the real exchange rate. Symbolically, denoting the real and nominal exchange rates e^r and e^n respectively, and the home price level, p (assuming the foreign price level unchanged):

$$e^r = e^n \cdot p$$

which implies that e^r increases (appreciates) with increases in p or with increases in e^n (or nominal appreciation).

According to chart 8.5 Tanzania's real effective exchange rate was relatively stable against an import-weighted basket and the KES during the period 1970 to 1978. However, during the same period, the exchange rate appreciated 48 % against the USD. During the subsequent period, 1979—82, relatively higher rate of inflation in Tanzania against her major trading partners caused the real effective exchange rate of the TZS to appreciate by over 92 % during 1979—82. For the period March 1979—December 1982, cumulative appreciation of the real exchange rate amounted to about 53 % and about 100 % against the USD and the KES respectively.

Overvaluation of the Tanzanian Shilling, as evidenced by the foregoing discussion, has been manifested in chronic balance of payments deficits for the country, starting from 1978 onwards, up to 1985 (cf. Chapter 2, and Annex 2.1).

8.6.2 Effective Exchange Rate and the Black Market Rate

The existence of foreign exchange controls, and import licensing, implies that there is an excess demand for foreign exchange, and some economic agents who are ready to purchase foreign exchange at prices above the official rate. This provides incentives for "black market" operations in foreign exchange.

My brief investigations on the black market exchange rates in Dar es Salaam during 1979—82 revealed the nominal rates presented in Table 8.13.

Table 8.13 supports the evidence provided in Charts 8.4 and 8.5, and suggests—under the assumption that the black market rates provide good ap-

Table 8.13. Tanzania: Nominal Black Market and Official Exchange Rates TZS against USD, 1979—82 (Annual Averages).

	1979	1980	1981	1982
1. Black Market Rate (Average)	20.00	35.00	50.00	65.00
2. Official Rate	8.29	8.24	8.31	9.40
3. (1) divided by (2)	2.41	4.25	6.02	6.91

Source: The Black market rates are Author's own observations, while the official rates are from Bank of Tanzania.

proximations for the true market value of the TZS—that the Tanzanian currency was overvalued by more than six-times during 1981—82.

The above analysis highlights the issue of an “overvalued” TZS, which has formed a subject of hot discussion between Tanzanian officials and the IMF. Basing itself on the above trends in the nominal and real effective exchange rates, the IMF has been pressing, in the discussions relating to Tanzania’s adjustment programmes out of the balance of payment’s crisis starting from 1979, that Tanzania should devalue substantially (by amounts ranging from 40 % in 1979 to over 80 % in 1981/82).

Concluding Observations

The analysis of the monetary base and the money multiplier in Tanzania during 1967—81, has shown that the expansion of the money supply recorded in that period was mainly due to growth in the monetary base, since the multiplier rose only slightly. The discussion of the monetary base suggested that its major source of growth was net claims in the public sector. On the one hand, the central government borrowed increasingly from the banking system (particularly the central bank) mainly to finance its development budget—including the expansion of the parastatal sector—up to 1977/78, after which a large proportion of the government borrowing was to finance current budget deficits. On the other hand, the increase in the non-central government bank credit during 1967—81 was increasingly allocated (by the way of financial planning) to the parastatals, which from the early 1970s have accounted for over 70 % of the total bank credit to the non-government sectors.

The financing of public sector deficits by borrowing from the central bank—printing money—took the lead among the methods of meeting the TPSFR, especially after relaxing the main legal restrictions on printing money in 1978. These restrictions were: one, the requirement to maintain minimum foreign reserves equivalent to the value of four months imports, and two, the limitation of the central bank’s acquisition of long-term government securities, and adoption of less restrictive limits on short-term lending to the government by the bank. In effect, by mid-1970s, domestic money creation had replaced the accumulation of net foreign assets as a major source of high-powered money (see Tables 8.3(a) and 8.3(b)). Arguably, therefore, during the period 1967—81, the government financed increasing public sector deficits by inflation tax, the value of which equals the inflation rate multiplied by holdings of cash balances.²²

The result of easy money printing after the formation of the central bank in Tanzania (1966—81) was relatively high rates of inflation, which accelerated fast after 1973, and even more so after 1978.²³

²² For more theoretical discussion of inflation tax, see Dornbush and Fisher (1981, Ch. 14).

²³ See Chapter 2, particularly Table 2.8.

The high inflation rates, in turn, led to a sharp appreciation of the exchange rate of the Tanzanian Shilling and large balance of payments deficits after 1978 (see Annex 2.1).

The shift in the backing of the monetary base from foreign assets during 1966—73 to claims on domestic sectors (including the government) thereafter, might suggest one reason why the inflationary effect of monetizing the public sector deficits differed between 1966—73 and 1973—81—even before the removal of restrictions on printing money in 1978. During 1966—73, domestic demand pressure could be contained by increased imports, and the exchange rate of the shilling pegged effectively at the desired level by the use of the reserves for intervention. In an economy like that of Tanzania, where the domestic monetary absorption is very much influenced by the capacity to import, the major constraint on the money supply should be conceived as the balance of payments rather than inflation (Newlyn (1966)). Given the low income per capita (averaging TZS 2500 = USD 250 in 1980—81), monetary expansion should imply (at least in theory), a sizeable and immediate impact on the demand for wage goods—especially food (accounting for over 50 % of private expenditures). Inelasticity in the supply of agricultural foods, as well as high propensity to import tend to force prices upwards unless foreign exchange is available to purchase imports. Moreover, monetary expansion is bound to raise the demand for capital goods component, in which imports occupy a considerable share (up to two-thirds according to estimates made by Green (1982)). Thus, a wide range of consumer and producer goods have to be imported. In this respect, assuming price stability in the rest of the world, monetary expansion can be carried without the fear of inflation. This was the characteristic situation for Tanzania during 1967—73, and studies that focused on the analysis of effects of monetary expansion on inflation, such as that of Rwegasira (1976) and Kuuya (1975), correctly detected a poor correlation between the two variables. It would be misleading, thus, on basis of 1966—73 monetary data to conclude, as Rwegasira (1976), that inflation in Tanzania was not “a monetary phenomenon” but rather a “structural” problem.

In the light of the inflationary experience, and the overvaluation of the TZS, the Tanzanian economy may be characterized as one that was in a state of critical internal and external monetary disequilibria, especially after 1978. The question of restoring balance has particularly been raised in the context of exchange rate adjustment, which has formed a subject of hot discussions between the IMF and Tanzanian officials. The former has argued for, and the latter against, devaluation.

In these discussions, the basic point of argument has resulted from the different points of view about the causes of the external and internal disequilibria in Tanzania's economy. The IMF has argued that the imbalances in the economy are mainly due to excessive monetary expansion, causing an ar-

tificially high aggregate demand. In the short-run, therefore, an increase in the import capacity to meet the excess demand would not guarantee a medium and long-term adjustment. The solution to the imbalances, according to the IMF, should be domestic demand compression. From the point of view of the Tanzanian officials, the disequilibria in the economy are largely due to a fall in the real supply, attributable to external factors. With this in mind, an injection of more import capacity (by external loans and grants), would trigger increased production and exports, and henceforth lead to rebalancing. In other words, the Tanzanian position emphasizes domestic supply enhancement as a solution to the crisis, rather than devaluation, which will—according to their view—merely cause uncontrollable inflationary spirals and undesirable income distribution effects.

Chapter Nine

Tanzania's Financial Development During 1950—80:

An Summary Assessment

Introductory Remarks

Having described the types of financial intermediaries that developed in Tanzania mainly during 1950—80. I shall then attempt, in this chapter, to make an aggregate assessment and comparison between the degree of financial development before (1950—65) and after the formation of the national central bank and the adoption of the Arusha Declaration (1966—80).

The conceptual background towards the assessment is the unrestricted versus restricted financial growth thesis discussed in Chapter one. Implicit in that discussion were the measures of financial growth in all its dimensions—widening, lengthening and deepening. Thus, it was suggested that widening of the financial system may be measured by growth in the number of actors in the system including savers, investors and financial institutions. This, however, is a very broad measure of financial widening. In a narrow sense, widening may be measured by growth in the number of specialized financial institutions.

As evident from the discussion in Chapter one, the criterion for financial lengthening is growth in the number of financial assets (or instruments) traded within the system, while that for financial deepening is growth in the ratio of the value of total financial assets to national wealth or income—the so-called financial interrelations ratio, or Goldsmith's criterion. Moreover, the discussion in Chapter one suggested that the main distinguishing factor between restricted and unrestricted financial regimes was the level of real interest rates. In particular, it was argued that real rates of interest tended to be high where finance is deepening, and low where it is shallow and regulated.

9.1 A Summary Assessment of Tanzania's Financial Development During 1950—80

In sections 9.1.1 and 9.1.2 of this chapter, an attempt is made to produce these measures for the two sub-periods of Tanzania's financial experience: 1950—65

and 1966—80. The ultimate idea is to compare the degree of financial growth in the two periods. This is done in section 9.2.

9.1.1 Tanzania's Financial Development During 1950—65

Table 9.1, which has been adapted from Table 4.2, presents some measures of change in the Tanzania's financial structure during 1950—66.

The first indication of Tanzania's financial development during the period under review is the rise in the ratio of total financial assets to GDP, from about 24 % in 1950 to about 33 % in 1955, mainly on account of growth of liabilities of the issuing authority (the EACB). For the rest of the period, 1955—65, the ratio of total financial assets to GDP more or less stagnated. However, it is worthwhile noting that throughout the period 1950—65, agricultural credit institutions increased their share in the financial asset menu—rising from 2.4 % in 1950 to 13.0 % in 1965 (see Table 4.2). This should be attributed to increased government concern over the productivity of agriculture, partly to cope with

Table 9.1. TANZANIA: Accumulation of Financial Assets 1950—65. (Summary Table).

RATIOS	Ratios in percentages			
	1950	1955	1960	1965
I. Ratio to Nominal GDP of:				
1. Total Financial Assets	24.2	33.1	30.6	32.5
2. Non-monetary Financial Assets	3.2	4.7	9.5	8.4
II. Ratio to Total Financial Assets of:				
3. Financial Assets of Commercial Banks	55.7	43.8	34.2	48.7
4. Currency in Circulation	31.0	42.1	34.9	25.5
5. Money Supply (M1)*	86.7	85.9	69.1	74.2
6. Financial Assets of Agricultural Credit Institutions	2.3	4.7	10.7	13.0
7. Financial Assets of Industrial Credit Institutions	--	--	--	4.9
8. Financial Assets of Contractual Savings Institutions	5.2	3.9	4.6	5.2
9. Financial Assets of Depository non-bank Institutions (POSB)	5.7	5.4	2.9	1.8
10. Financial Assets of Housing Credit Institutions	--	--	11.8	1.0

Notes: * Money supply has been obtained from Appendix Table 8.4, by adding short-term commercial bank assets to currency in circulation.

-- Not available; - - Nil.

Source: Adapted from Table 4.2 (GDP figures were obtained from Statistical Abstract of Tanzania, various issues).

the increased export demand related to the Korean War and the rapid rehabilitation of the post-war Europe, and hence the concern over the availability of credit to both small-holder and large scale producers. Moreover, the policies of 'monetary nationalism' conducted by the post-independence government had first impact on agricultural finance, witness the formation of the Agricultural Credit Agency, the National Development Credit Agency and the National Cooperative Bank. Indeed, it was only during 1950—55 that the issuing authority (EACB) increased its share (currency) in the total financial assets, and it was only during this period that marked financial deepening was recorded—evidenced by a sharp rise in the ratio of total financial assets to GDP.

The relative stagnation of the ratio of total financial assets to GDP during 1955—65 suggest that the period was one of limited financial growth. There was, however, some degree of financial development, and this is seen from the qualitative specialization, implying widening and/or lengthening in the financial industry. It is seen, for example, that the issuing authority and commercial banks combined retrogressed relative to the other financial institutions. Thus, the share of currency in circulation in total assets fell from 42.1 % in 1955 to 25.5 % in 1965. Commercial bank assets fell from 43.8 % in 1955 to 34.2 % in 1960, and then increased to 48.7 % in 1965. The increase in the share of the commercial banks during the first half of the 1960's was, as discussed above, associated with lengthening of their activities, to include lending to riskier areas than the foreign trade sector alone.

The retrogression of the monetary system, especially the monetary authority, is also reflected in the declining share of money supply (M1) in the total financial assets. This share decreased from 81.3 % in 1950 to 61.5 % in 1965.¹ The decline in the share of the monetary system during 1950—65 was matched by increasing shares of non-bank financial intermediaries. Thus, the agricultural credit institutions continued to increase their share in total assets from 4.6 % in 1955 to 13.0 % in 1965, with the result that the ratio of their assets to the agricultural sector GDP also rose markedly from 2.5 % to 9.2 % in the corresponding years.

As seen from Table 9.1, during 1950—65, specialized industrial credit institutions developed, and contributed about 5 % of total financial assets in 1965. However, assets of depository non-bank institutions, particularly the Post Office Savings Bank (POSB), declined. This was mainly due to increased competition of the commercial banks and the other specialized financial intermediaries.

A closer examination of the monetary system alone, of which data are more

¹ According to Raymond Goldsmith (1969), the liabilities of the monetary authorities and deposit banks in the developing countries, on average, account for about two-thirds of total financial assets.

reliable, is presented in Annex 9.1. According to this annex, the ratio of money supply broadly defined (M2) to GDP declined from about 52 % in 1954 to 33 % in 1954.² During this period, the inflation rate—measured by changes in the retail price index—was negligible, and monetization of the economy was taking place at a rapid pace (see Chapter 2), so that there is no explicit reason for the recorded decline in the demand for money: the income velocity of money rose from 2.4 in 1954 to 3.5 in 1964.

My hypothesis for the stagnation in the ratio of total financial assets to GDP, and the decline in the ratio of M2 to GDP in particular, is that there were some institutional rigidities which hindered the interest rates from rising to levels that would have attracted enough savings—in form of saving and time deposits, etc. to compensate for the decline in the non-interest earning component (currency and demand deposits) of M2. I attempt to point out these rigidities in the following section.

Causes for 'Limited' Financial Growth During 1955—65

During 1955—1965, the government had no controls over the financial system and, by virtue of the convertibility of the local currency safeguarded by the Currency Board mechanism of issue, it would be appropriate to classify the pre-1966 Tanzania's economy as being "small and open".³ Such openness of a developing country to the more developed 'rest-of-the-world' may be a source of continued underdevelopment of the former. This suspicion is justified at least from the point of view of the thesis of "circular cumulative causation" propounded by Myrdal (1957) and from Myint's "export-bias" doctrine.⁴ Here we are concerned with the repressive effects of this phenomenon on the financial system.

Monetary openness of the Tanzania's economy during 1955—65 implied, inter alia, the acceptance of an interest rate structure that was characteristic of

² Money supply narrowly defined (M1) includes currency in circulation and demand deposits, while money supply broadly defined (M2) is M1 plus saving and time deposits.

³ 'Small and open' in the sense used to refer to economies like those of Scandinavia. Such economies are above all, price-takers at the world market and are heavily dependent on foreign trade. See chapter 1 above and Dornbusch (1980 ch. 1).

⁴ According to Myrdal, a social process tends to become cumulative and often to gather speed at an accelerating rate. Thus, the more advanced countries will exert a strong agglomerative pull, accelerating their rate of growth and bringing increasing impoverishment to the backward ones. See Myrdal (1957, pp. 13, 28—29).

Myint takes a dualistic view of underdeveloped countries, and propounds his 'export-bias' doctrine, suggesting that the tradable and the non-tradable sectors of the backward countries are "non-competing" so that an export-bias strategy might contribute to the lack of secondary rounds of activities—a factor that limits the spread effects of international trade in these regions. See H. Myint (1954, p. 146) and also his "The Gains from International Trade and the Backward Countries" in *Review of Economic Studies*, Vol. XXII, No. 2 (es. p. 140).

the developed capitalist economies (and more specifically, of the London market). However, by virtue of the differences in the composition of demand for various financial services (manifested in differences in economic structures), and in the relative scarcity of finance in Tanzania *vis à vis* the 'advanced world' there was theoretically a case for a higher interest rate structure for Tanzania relative to that presented by the London market. Moreover, this could also be justified by the extra costs of 'learning by doing' in the financial industry, because most of its specialized sectors (like insurance) were alien enterprises for the indigenous Tanzanians, and entailed new types of risks and costs for the foreign pioneering firms. Thus, monetary openness, coupled with the Credit to Natives Restriction Act of 1931, might have been the main institutional features that tended to stop interest rates from rising to levels consistent with the costs and risks in the economy, thereby causing the development of the domestic financial sector to lag behind that of the non-financial sector during the period under review.

Another factor limiting financial growth in the period prior to 1966 concerns the bank charter policy. As discussed in chapter four, the banking industry in Tanzania was oligopolized by "The Big Three", which in the absence of any banking ordinance (1954—59), and even after the enactment of the Banking Ordinance in 1960, dictated the terms of commercial banking—thereby imposing implicit loan and deposit rate ceilings. Absence of a competitive bank chartering might have reinforced the effects of the economic openness, by enabling the institutions to maintain an inefficient spread between deposit and loan rates. For example, whereas demand deposits which accounted for over 80 % of commercial bank liabilities earned no interest (and the EACB rediscount and advance rate for crop financing was 5 % per annum) in 1965, commercial bank short-term lending earned interest at about 8 % per annum in the same period. Although these figures by themselves are not enough to assess the efficiency of the interest rate spread in terms of marginal costs and revenues of the banking institutions, they suggest a relatively high revenue and profit margin.

The cartel spearheaded by the agreement among the "Big Three" from 1929 with conditions leading to the statement embodied in a document called 'Summary of banking Arrangements', was safeguarded for the purpose of eliminating competition and provide artificially high profits for the banks. Implicit in the agreement of the 'Summary' was a strategy to hinder the expansion of new banks and hence the spreading of the bank branch network, better financial services and experience. By its scale of minimum lending amounts and charges, it may be presumed that the cartel unduly deterred the small customer, especially the African farmer from access to formal finance.

9.1.2 Tanzania's Financial Development Since the Mid 1960's

The indicators of financial development in Tanzania during 1968—80 are presented in Table 9.2.

According to Table 9.2 the total financial assets to GDP ratio for Tanzania rose sharply up to 1976—a period including the first phases of development of the BOT and the NBC, and mainly characterized with relatively low inflation rates (excluding 1974—75). In the period after 1976, however, the ratio more or less stagnated. From this indicator (i.e. the ratio of total financial assets to GDP), it may be concluded that Tanzania experienced fast financial growth in the period up to the mid-1970s. Nevertheless, the degree of financial development—as reflected by this ratio—remained low in Tanzania, when compared with other developing countries.⁵

That the period 1968—80 should be characterized as one of not only limited financial development, but rather of financial retrogression in Tanzania, may be seen from Table 9.2. According to that Table, and in line with the discussion in Chapter 8, the rise in the financial interrelations ratio during 1968—76 was almost entirely due to growth in the assets of the monetary institutions—the commercial bank and the central bank—implying that there was neither widening nor lengthening of finance. In fact the ratio of non-monetary financial assets to GDP stagnated at an average of 8.1 % as compared with a use from 3.2 % in 1950 to over 8.0 % in 1965.

These institutions seem to have expanded their assets at the expense of other specialized financial institutions. This is against the expectation that the share of the monetary system in the total financial assets would have risen more or less proportionately as that of other financial intermediaries to indicate financial widening and lengthening. On the contrary, the monetary system increased its share in the total assets, from about 76 % in 1968 to 83 % in 1980. On the other hand, the share of specialized agricultural credit institutions fell from 8.4 % in 1968 (and 13.1 % in 1965, see Table 4.2) to below 2 % in 1980.

Similarly, the share of contractual savings institutions in the total assets of the financial system decreased from about 7 % in 1968 to 4 % in 1980. A slight rise was recorded in the share of industrial finance institutions in the total financial assets.

One main reason that may be advanced for the relatively slow rate of growth of financial institutions and instruments in Tanzania during 1967—80 is interest rate regulations (ceilings) especially in the 1970s. Table 9.3 summarizes the movements in the real interest rates of the main financial assets during 1967—81.

⁵ According to Goldsmith's (1969) findings, the financial interrelations ratio lies in the range of 100—150 % for developed capitalist economies, and between 67—100 % for most developing countries.

*Table 9.2. TANZANIA: Accumulation of Financial Assets During 1968—80.
(Summary Table)*.*

RATIOS	Ratios in percentages				
	1968	1973	1976	1978	1980
I. Ratio to Nominal GDP of:*					
1. Total Financial Assets	30.4	39.2	47.3	48.0	46.1
2. Non-monetary Financial Assets	7.2	7.1	8.3	10.0	7.9
II. Ratios to Total Financial Assets of:					
1. Financial Assets of Commercial Banks	54.0	57.2	63.4	60.1	61.0
2. Currency in Circulation	22.4	24.8	19.1	19.0	21.9
3. Money Supply (M1)	76.4	82.0	82.5	79.1	82.9
4. Financial Assets of Agricultural Credit Institutions	8.4	2.4	1.5	2.0	1.5
5. Financial Assets of Industrial Credit Institutions	6.3	7.3	10.4	12.1	8.9
6. Financial Assets of Contractual Savings Institutions	6.5	5.0	3.7	3.3	3.8
7. Financial Assets of Depository non-bank Institutions	1.6	1.3	0.9	1.0	0.9
8. Financial Assets of Housing Finance Institutions	0.8	1.5	1.0	2.5	2.0

Note: * As argued in the JASPA Report on Tanzania (1982), the GDP deflator, especially after 1977, has tended to under-estimate severely the price movements in Tanzania. Thus, in the calculation of the financial assets to GDP ratio, I have chosen to deflate the constant price GDP by the National Consumer Price Index, rather than the official implicit GDP deflator.

Source: Adapted from Table 7.0 (GDP figures are from Tanzania National Accounts).

*Table 9.3. Tanzania: Real Interest Rates on Selected Financial Assets, 1967—80
(in percentages).*

	1967-69	1970-73	1974-77	1978-81
1. Central rates on				
1.1 Crop Bills (90-days)	2.9	-1.5	-9.1	-11.5
1.2 Other Commercial Bills (90-days)	2.3	-1.3	-8.5	-10.6
1.3 Treasury Bills	1.5	-2.2	-9.7	-12.9
2. Commercial Bank Rates				
2.1 Savings Deposits	0.6	-2.8	-9.9	-12.3
2.2 Time Deposits:				
a) 3—6 months maturity	1.1	-2.4	-9.9	-13.1
b) 9—12 months maturity	3.5	-0.6	-9.5	-12.7

Source: Adapted from Chapters 4 and 5.

One may interpret Table 9.3 as showing the extent to which the imposition of ceilings on nominal rates of interest has taxed (by inflation) the holdings of financial assets in Tanzania, especially during 1970—81. During the period immediately after the formation of the national central bank (1966—69), real interest rates on the major financial assets were low, but at least positive.⁶

When assessed in the context of the financial development experienced during 1950—65, as presented in Table 9.1, the above trends suggest the case for 'financial disintermediation' in Tanzania during the post-Arusha period, 1967—80. In this case, by 'financial disintermediation' I mean low interest rate ceilings, coupled with other fiscal controls of the financial system, both of which hamper the process of financial specialization and savings mobilization. The ultimate result is that the Government tends to resort persistently to the monetary system for meeting its deficits (rather than by borrowing from the private sector, where savings decline because of the heavy inflationary taxation on savings)—and hence the vicious circle of inflation and restrictions discussed in chapter 1. Undoubtedly, such resource leads to a relative increase in the share of the monetary system in the total financial system, but at the expense of non-monetary intermediaries.

9.2 Summary of Conclusions

Our hypothesis regarding the periodization of Tanzania's post-war experience into two sub-periods, 1950—65 and 1966—80, has proved to be a useful framework for discussing the country's financial experience. Both these sub-periods may be characterized as periods of limited financial development, due to financial restrictions. However, the two-periods differ in terms of the extent and causes of restrictions.

During the first sub-period, 1950—65, financial restrictions were less pronounced, and were caused by institutional characteristics of the financial system, rather than by public policy. In particular, the requirement of 'first class'⁷ collateral and/or well known reputation of the banks (which were mainly multinational during 1950—65), ruled out the possibility for the indigenous enterprises to compete with the foreign-affiliated ventures for savings mobilized by the financial institutions operating in the country. Consequently,

⁶ The trends in the lending interest rates are the same (see, for example, chapter 5).

⁷ Such 'first class' securities were beyond the reach of the indigenous entrepreneurs. The foreign-affiliated ventures which had access to formal borrowing included import/export activities, protected manufacturing, international corporations and various government agencies.

the interest rates that ruled over the period were biased downwards, in relation to those which would have obtained if the credit demands by the indigenous sectors were taken into consideration.

In the second sub-period, 1966—80, the country had an independent central bank and the financial system was mainly nationalized. These two features were used by public policy to ensure the rationing of the national financial resources in favour of the public sector of the economy, which expanded considerably during the period. The crowding-out of the rural and small-scale urban activities by the public sector during 1966—80, was exacerbated by the practice of regulated nominal interest rate ceilings, coupled with high rates of inflationary financing of public debts, both of which created a regime of low (and in most cases, negative) real interest rates. It may, therefore, be argued that during 1966—80 financial restriction was much more severe than in 1950—65.

An important conclusion from the study is that during the post-war period, especially 1966—80, financial restriction had the effect of under-pricing the scarce financial resource, thereby forcing savers to reduce their real holdings of money, near-monies and other financial assets.

With the nationalized financial institutions and financial planning of Tanzania after 1966, ceilings on nominal rates of interest acted like a 'fiscal' instrument for taxing savers and subsidizing borrowers. This implied disincentives to the bulk of small depositors, who were severely crowded-out of the formal financial system.

In terms of McKinnon's (1973) "fragmentation hypothesis",⁸ the period 1966—81 may be characterized as one of financial 'disintermediation' because financial policies led to further fragmentation of the country's capital market: the private sector was discriminated vis à vis the public sector in the competition for financial resources of the formal institutions. Arguably, the rationing of financial resources by non-market criteria (including financial planning) tended to reinforce self-finance and informal financial markets.

Finally, it should be noted that financial restriction in Tanzania during 1966—80 was associated with an increasing reliance on monetary creation as a source of financing public sector deficits. Monetary creation, especially after 1977, caused persistently high rates of inflation, which in turn led to an over-valuation of the Tanzanian Shilling (in the presence of exchange controls) and large balance of payments deficits.

⁸ Enlarging the sphere of external finance, as opposed to self-finance is, according to McKinnon (1973), the only way for unification of the capital market in the financially underdeveloped economies.

9.3 Policy Implications

From the analysis of the development of Tanzania's financial system mainly during 1950—80, it is evident that the growth of the major financial institutions, especially in the post-independence period, has very much been influenced by active government policy. Here I shall confine myself to noting some of the main weaknesses—apart from those of regulations of financial prices and quantities, which have been discussed at length in this chapter—in the financial policy, that could be rectified.

First, it is notable that the financial structure in Tanzania has been 'volatile' over time, and this might have had negative effects on public confidence in the system. This volatility has mainly resulted from the government's tendency to establish financial institutions on ad-hoc basis (without careful studies). There is an obvious need that future reorganizations of the financial system be studied more thoroughly, and attempts be made to stabilize the already existing financial institutions instead of designing new ones.

The second weakness pertains to branch expansion *per se*. It has been taken for granted that the geographical spread of banking offices will induce financial savings. Nevertheless, the experience of the Post Office Savings Bank and the National Bank of Commerce, for example, illustrates that for such expansion (investment) to be fruitful it must be accompanied with an offer of attractive yields on the respective financial assets. The commonly held proposition that small savers are irresponsive to interest rates seem unrealistic in the light of the evidence provided here.

One of the main problems facing the financial institutions in Tanzania, especially during 1967—80, has been loan recovery. The situation could obviously be improved if the legal standing of the institutions was reframed to give them more legal authority of eliciting loan repayments, particularly from the parastatals.

As far as agricultural credit is concerned, it would seem that the land tenure system, by depriving small farmers the right to mortgage their land, has hampered the extension of credit to the majority of the population (peasants). The crux of the matter is that land is almost the only security that small farmers can offer for credit, and without the possibility of doing so, they will—for a long time to come—remain cut-off from access to formal credit institutions.

In the sphere of monetary policy, the study points to the need for an increase in the interest rates and a systematic adjustment of the rates to the annual inflation rates in the years to come. A systematic quarterly or semi-annual review of the exchange rate could bring it in line with domestic and external monetary developments. This will avoid the need for huge and discrete devaluations.

Without fiscal policies capable of restricting government spending and/or

legal restrictions on the central bank's lending to the government, as before the 1978 Amendments of the BOT Act, it seems that financial planning will remain ineffective. However, in order to ensure monetary stability, imposition of restrictions on government borrowing from the Commercial Bank will also be necessary, because in the case of Tanzania, borrowing from the NBC is quite similar to borrowing from the Bank of Tanzania.

Finally, it should be noted that the deterioration of modern financial intermediation in Tanzania has probably implied an expansion of the informal financial sector, and hence relative ineffectiveness of monetary and fiscal policies directed solely to the formal sector. A thorough study of the informal sector, therefore, remains of crucial importance to ascertaining the role of government policy in Tanzania.

STATISTICAL APPENDIX
(Annex Tables)

*Annex 2.1. TANZANIA: BALANCE OF PAYMENTS ESTIMATES (SUMMARY): 1961—80 (in Million USD)***.*

	1961	1962	1963	1964	1965	1966	1967	1968	1969
1. Exports, f.o.b.	152.1	151.6	185.9	213.0	199.0	259.2	244.4	238.0	240.4
2. Imports, f.o.b. (—)	128.4	133.0	136.7	152.5	167.4	219.1	212.5	229.9	218.1
3. TRADE BALANCE	23.7	18.6	49.2	60.5	31.6	40.1	31.9	8.1	22.3
4. Services and Transfers (Net)	—23.7	—23.5	—31.1	—28.9	—33.5	—46.1	—34.5	—14.2	2.9
5. CURRENT ACCOUNT BALANCE	—	—4.9	18.1	31.6	—1.9	—6.0	—2.4	—6.1	25.2
6. CAPITAL ACCOUNT BALANCE	—0.3	0.5	—4.4	21.6	14.9	19.6	—6.1	22.2	6.1
7. ERRORS AND OMISSIONS	—5.0	6.6	—9.5	—54.3	—9.4	9.0	6.9	—1.1	—29.6
8. Exceptional Financing**	—	—	—	—	—	—	2.0	0.8	1.0
9. OVERALL BALANCE (= CHANGE IN RESERVES)*	5.3	—2.2	—4.2	1.1	3.6	—22.5	—0.4	—15.8	—2.7

Notes: *** To convert the USD figure into TZS, use the following average exchange rates: 1961—73 USD 1 = TZS 7.2; 1973—80 USD 1 = TZS 8.0.

** Includes the World Bank and OPEC Programme loans. * A Minus (—) implies an increase in reserves.

Source: IMF, International Financial Statistics, 1984.

ANNEX 2.2. TANZANIA: MAJOR EXPORT CROP PRODUCTION INDICES, 1970—81. (1970 = 100)

	1970/71	1971/72	1972/73	1973/74	1974/75	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81
1. Cotton	100.0	89.4	100.6	84.3	92.1	55.5	87.6	82.6	73.4	79.0	76.5
2. Coffee	100.0	92.3	103.9	70.1	109.0	111.5	98.0	106.0	99.0	104.2	135.9
3. Sisal	100.0	89.6	77.6	76.9	70.3	63.2	58.0	51.9	40.3	40.3	42.5
4. Tea	100.0	123.1	143.6	148.4	152.8	161.7	196.7	192.9	207.1	204.7	198.7
5. Cashewnuts	100.0	109.3	109.7	130.5	105.4	74.6	87.1	61.2	51.3	37.0	57.6
6. Pyrethrum	100.0	158.1	185.0	150.0	205.2	170.8	140.8	113.0	69.6	60.9	86.8
7. Tobacco	100.0	118.2	108.6	157.9	117.0	124.5	159.6	163.3	142.5	159.2	99.2

Source: Bank of Tanzania, Economic and Operations Report, various.

1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
245.9	262.0	316.2	363.6	399.2	372.9	490.3	540.2	478.3	543.5	507.7
283.5	345.3	359.8	437.8	660.4	670.0	555.4	648.7	998.7	956.8	1069.0
-37.6	-83.3	-43.6	-74.2	261.2	-297.1	-65.2	-108.5	-520.4	-413.3	-561.2
2.0	-16.5	-22.0	-33.4	-24.0	67.1	31.5	48.2	43.1	69.5	27.9
-35.6	-99.8	-65.7	-107.5	-285.3	-230.0	-33.7	-70.3	-477.4	-343.8	-533.3
63.8	100.2	105.1	134.5	138.1	226.3	60.4	161.1	296.6	263.4	238.0
-48.8	-13.7	10.6	5.0	9.7	-11.0	-4.4	68.6	10.3	23.5	229.1
5.3	8.6	9.3	-6.9	-4.4	-4.1	0.7	2.0	10.4	-3.9	11.7
15.3	4.7	-59.3	-25.0	142.0	10.5	-23.0	-161.4	160.1	60.8	54.5

ANNEX 4.1. TANZANIA: COMMERCIAL BANKS—SOURCES AND USES OF FUNDS, Selected Years in 1938—65. (End of Year Figures).

	1938*	1946*	1956	1958	1960	1961	1962	1963	1964	1965
I. SOURCES OF FUNDS										
1. Domestic Deposits (Total)	36.0	189.0	404.7	401.2	390.7	552.1	641.1	702.9	755.2	897.2
of which:										
1.1 Demand deposits	..	164.5	292.2	289.1	296.9	427.1	484.2	498.4	564.1	662.6
1.2 Time deposits	..	16.1	75.8	67.2	44.0	73.3	96.2	124.0	101.7	132.4
1.3 Savings deposits	..	8.4	36.7	44.9	49.8	51.7	60.7	80.5	89.4	102.2
2. Other Liabilities	..	1.2	25.9	24.6	38.5	36.1	51.0	50.7	77.6	88.3
TOTAL SOURCES (= USES OF FUNDS)										
	..	190.2	430.6	425.8	429.2	588.2	692.1	753.6	832.8	985.5
II. USES OF FUNDS										
3. Cash Holdings	..	21.1	30.0	31.7	41.3	24.0	33.5	32.9	44.5	32.4
4. Net Lending to Other										
Banks, Total	..	150.0	186.6	148.1	10.3	78.3	96.4	130.9	40.9	-2.2
of which:										
4.1 To Banks in Tanzania	..	1.5	0.5	-0.5	1.6	0.2	10.3	16.0	7.2	24.2
4.2 To Banks Abroad	..	148.5	186.1	148.6	8.7	78.1	86.1	114.9	33.7	-26.4
5. Lending to Domestic Sectors, Total	30.5	17.7	184.7	203.0	313.3	391.1	465.7	466.0	632.6	863.2
of which:										
5.1 Agriculture	..	6.1	40.9	52.7	101.0	74.4	119.8	189.0	194.3	243.6
5.2 Industry	..	3.2	43.5	39.6	45.4	45.4	69.5	55.7	55.2	74.5
5.3 Other Sectors	..	7.8	71.0	84.5	147.0	257.1	276.5	200.0	383.1	545.1
6. Investments in Other E.A.	..	—	1.0	1.2	5.6	30.1	14.0	30.4	18.7	13.6
7. Other Assets	..	1.4	28.3	41.8	58.7	64.7	82.5	93.4	96.1	78.5
III. RATIOS OF										
8. Domestic Deposits to Total Liabilities	..	99.4	94.0	94.2	91.0	93.9	92.6	93.3	90.7	91.0
9. Domestic Assets to Total Assets	..	21.2	49.8	55.0	83.0	70.6	73.6	68.3	82.2	93.3

Notes: .. Not Available; * Includes Zanzibar, otherwise only for Tanzania Mainland; ** Should read — 'Investments to Other East African Countries'; *** Domestic assets defined to include lending to banks in Tanzania, cash reserves, and lending to domestic sectors.

Sources: Dow-Smith (1952, pp. 10—11); and Tanzania: Statistical Abstract, Various issues.

ANNEX 6.1. ANALYSIS OF COMMERCIAL BANK DEPOSITS, 1966—1980. (Nominal values in million TZS, End of June).

DEPOSIT INDICATORS	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
1. TOTAL DEPOSITS	930	887	1070	1374	1568	1946	2218	2691	3142	4028	5115	6040	6635	9259	11469
of which:															
1.1 Demand Deposits	724	666	618	746	822	1078	1129	1345	1846	2711	3391	3885	4227	6131	7713
1.2 Saving Deposits	206	221	158	172	194	212	262	352	403	466	554	720	897	1031	1251
1.3 Time Deposits			294	456	552	656	827	994	893	851	1170	1435	1511	2097	2565
2. PRIVATE SECTOR DEPOSITS*	567	648	692	889	871	1074	1243	1568	1971	2423	2854	3863	4445	6518	8078
% Share in Total Deposits	61.0	73.1	64.6	64.7	55.5	55.2	56.0	58.3	62.7	60.0	55.8	64.0	67.0	70.4	70.4
3. PUBLIC SECTOR DEPOSITS	363	239	378	486	697	872	976	1123	1171	1605	2261	2177	2190	2741	3391
of which:															
3.1 Central Government	199	86	141	105	320	333	453	548	433	539	576	513	290	374	413
3.2 Parastatals	164	152	153	255	218	353	321	445	554	766	1414	1271	1562	2167	2915
3.3 Other public sector			85	126	159	186	202	130	184	301	271	393	338	200	63
4. % share of Savings plus Time Deposits in Total Deposits	22.1	25.0	42.2	43.7	47.6	44.6	48.2	50.0	41.3	32.7	33.7	35.7	36.3	33.8	33.3

Notes: * Includes a very small amount of foreign deposits, accounting for some 1—5 % of the indicated amount.

Source: Adapted from the Bank of Tanzania: Economic and Operations Report, Various Issues.

ANNEX 6.2. SOME SELECTED REAL INDICATORS OF COMMERCIAL BANK DEPOSIT PERFORMANCE, 1966—80. (Values are in real terms and in Million TZS, End of June).

INDICATORS	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
1. Deflators used*	0.89	0.91	0.95	0.97	1.00	1.05	1.13	1.25	1.48	1.88	2.01	2.24	2.49	2.84	3.69
2. Total Deposits (real) value, at 1970 prices	1045	975	1126	1417	1568	1853	1963	2153	2123	2143	2545	2697	2665	3260	3108
Growth Rate (%)	13.8	-6.7	15.5	25.8	10.7	18.2	5.9	9.7	-1.4	0.9	18.8	6.0	-1.2	22.4	-4.7
3. Demand Deposits (real)	814	731	651	769	822	1026	999	1076	1248	1442	1687	1735	1698	2159	2090
Annual Growth Rate (%)	17.5	-10.1	-11.0	18.2	6.9	24.8	-2.7	7.8	15.9	15.6	17.0	2.8	-2.1	27.2	-3.2
4. Savings Plus Time Depos.	231	243	475	648	746	827	964	1077	877	701	857	962	967	1102	1034
Annual Growth rate (%)	2.4	5.5	95.4	36.2	15.2	10.8	16.6	11.7	-18.5	-20.2	22.4	12.2	0.5	13.9	-6.1
5. Private Sector Deposits	637	712	728	916	871	1023	1099	1239	1332	1289	1420	1725	1785	2295	2189
Annual Growth Rate (%)	19.4	11.9	2.2	25.9	-4.9	17.4	7.5	12.7	7.5	-3.2	10.2	21.5	3.5	28.6	-4.6
6. Public Sector Deposits	408	262	398	501	697	830	864	898	791	854	1125	972	880	965	919
Annual Growth Rate	6.1	-35.7	51.8	25.7	39.3	19.1	4.0	4.0	-11.9	7.9	31.7	-13.6	-9.5	9.7	-4.8
7. Total Deposits to GDP Ratio (%)	14.3	13.2	14.9	18.4	19.1	22.0	22.1	23.4	22.4	23.7	24.8	23.1	22.1	28.1	32.2
8. Saving plus Time Deposits to GDP Ratio (%)	3.2	3.3	6.3	8.4	9.1	9.8	10.9	11.7	9.2	7.8	8.3	8.2	8.0	9.4	10.7

Notes: * For the period 1966—69 the deflators are the Retail Price Indices, while from 1970 onwards the National Consumer Price Index (NCPI) has been used. A full set of these indices is obtainable from the Tanzania: Twenty Year (1961—80) Survey, Appendix Tables (see also the Bank of Tanzania: Economic and Operations Reports, various issues).

Source: Adapted from Annex 6.1. GDP Figures were obtained from Tanzania: National Accounts (of), various issues.

ANNEX 6.3. NBC NOMINAL AND REAL LOAN RATES, 1971 and 1981 (in %).

TYPE OF ECONOMIC ACTIVITY	LENDING RATES			
	1971 Nominal	Real	1981 Nominal	Real
1. PRIMARY PRODUCTION AND MARKETING				
1.1 Ujamaa Villages/District Development Councils	6.5	1.4	7.5	-14.5
1.2 Cooperatives	6.5	1.4	7.5	-14.5
1.3 Marketing Boards/Crop Authorities	7.0/7.5	1.9/2.3	8.0/8.5	-14.1/-13.7
1.4 Farming, small scale	8.0	2.9	9.0	-13.3
1.5 Foreign Controlled Production	9.0/10.0	3.8/4.8	12.0	-10.9
1.6 Mining	8.0	2.9	9.0	-13.3
2. SECONDARY PRODUCTION				
2.1 Industrial ventures (private)	8.0	2.9	9.5	-13.3
2.2 District Dev. Corporations' undertakings	6.5	1.4	9.5	-12.9
2.3 Small-scale Industries (mainly private)	6.5	1.4	8.0	-14.1
2.4 Construction	8.0	2.9	9.5	-12.9
2.5 The National Electricity Corp. (TANESCO)	6.5/7.0	1.4/1.9	9.5	-12.9
2.6 Foreign Controlled Industry	9.0/10.0	3.8/4.8	12.0	-10.9
3. SERVICES				
3.1 Wholesale Trade				
3.1.1 Imports—Consumer Goods	8.0/9.0	2.9/3.8	12.0	-10.9
3.1.2 Imports—Other	8.0	2.9	10.0	-12.5
3.1.3 Domestic	8.0	2.9	10.0	-12.5
3.1.4 Exports	7.5	2.3	7.5	-14.5
3.2 Retail				
3.2.1 Multipurpose and Consumer Coops.	6.5	1.4	7.5	-14.5
3.2.2 Motor Vehicles	8.0/9.0	2.9/3.8	9.0/10.0	-13.3/-12.5
3.2.3 Tourism	7.5	2.3	9.0	-13.3
3.2.4 Transport	8.0	2.9	10.0	-12.5
3.2.5 Other Financial Institutions	8.0	2.9	9.0	-13.3
3.2.6 Consumer Credit, Personal Loans	9.0/10.0	3.8/4.8	12.0	-10.9
3.2.7 Other Services	8.0/9.0	2.9/3.8	10.0	-12.5
3.2.8 Intergovernmental Commercial Corp.	8.0	2.9	12.0	-10.9
3.2.9 Foreign Controlled Trading	9.0/10.0	3.8/4.8	12.0	-10.9

Sources: Figures for 1971 were obtained from *The Banker*, Quarterly Issue No. 10, June 1974, p. 8. Those of 1981 are from Bank of Tanzania: Economic and Operations Report, 1982, pp. 62-63. The formula used for calculating the real rates is similar to that of Table 5.9(b).

ANNEX 7.1. TANZANIA: MONEY SUPPLY—Nominal and as percent of GDP at market prices: 1966—81. (In million TZS, except where indicated otherwise). End of June.

Year	Currency in circulation outside banks	Demand deposits (non-government)	M1	Time + saving deposits*	M2	M2 as % of GDP at market prices**
1966	440.4	465.8	906.2	303.5	1209.7	17.2
1967	421.6	560.0	981.6	347.6	1329.2	18.1
1968	440.4	618.4	1058.8	285.0	1343.8	17.1
1969	508.5	746.2	1254.7	619.8	1874.5	22.7
1970	615.9	822.3	1438.2	741.4	2179.6	23.8
1971	817.2	1077.7	1894.9	855.4	2750.3	28.0
1972	924.3	1128.6	2052.9	1072.2	3125.1	28.0
1973	1078.2	1345.4	2423.6	1304.5	3728.1	28.5
1974	1233.0	1846.3	3079.3	1263.6	4342.9	27.2
1975	1423.0	2711.0	4134.0	1295.5	5429.5	28.6
1976	1760.3	3016.8	4777.1	1375.6	6152.7	26.3
1977	1950.9	3510.6	5461.5	1831.8	7293.3	28.1
1978	2214.4	3879.9	6094.3	2195.7	8290.0	27.6
1979	2846.7	5614.7	8461.4	2952.3	11413.7	28.7
1980	4175.5	7174.3	11349.8	3680.8	15030.6	30.9
1981	5195.1	8574.1	13769.8	4509.1	18278.9	36.4

Notes: * For 1966—68 the figures in this column pertain to end of year.

** Real GDP figures for 1979—81 were converted to current prices by using the NCPI, rather than the implicit GDP deflator, which has been shown to underestimate price movements during that period (see JASPA Report on Tanzania, 1982).

Source: Bank of Tanzania: Economic and Operations Report, various issues. (GDP figures are from National Accounts.)

ANNEX 7.2. Analysis of sources of Base Money in Tanzania (1967—81)* (in million TZS).

Year	Net Foreign Assets of Central Bank		Net Claims on Govt. Net		Net Lending to Banks* Central Bank		Other Assets		Total Net Assets of
	Value	%	Value	%	Value	%	Value	%	
1967	417.7	97.0	—11.9	—2.8	29.9	6.9	—5.3	—1.2	430.4
1968	490.5	98.7	—27.0	—5.4	—2.6	—0.6	36.3	7.3	497.2
1969	439.9	94.0	12.9	2.8	—7.6	—1.6	22.9	4.9	468.1
1970	700.4	75.6	195.7	21.1	30.9	3.3	—1.0	0.0	926.0
1971	763.3	61.6	435.4	35.2	105.7	8.5	—65.9	—5.3	1238.5
1972	874.9	61.7	557.0	39.3	72.1	5.1	—86.6	—6.1	1417.4
1973	1291.6	81.3	431.1	27.1	—35.7	—2.2	—97.4	—6.0	1589.6
1974	874.6	42.5	759.1	36.9	525.5	25.5	—102.3	—4.9	2056.9
1975	677.8	27.3	1052.4	42.4	867.3	34.9	—115.3	—4.6	2482.2
1976	1149.6	36.0	1359.9	42.5	747.2	23.4	—59.1	—1.8	3197.6
1977	2153.5	59.6	1345.0	37.3	196.3	5.4	—84.1	—2.3	3610.7
1978	1730.0	44.5	1685.4	43.4	589.1	15.2	—120.5	—3.1	3884.0
1979	959.6	19.6	3898.4	79.8	48.8	1.0	—21.1	—0.4	4885.7
1980	902.6	14.3	3986.3	78.7	304.9	4.8	141.5	2.2	6335.3
1981	978.3	17.5	4493.5	80.5	219.5	3.9	—107.4	—1.9	5583.9

Notes: * All figures have been derived net of liabilities, and with the exception of the item “net lending to banks” pertain to end-of-June. The “net lending to banks” was estimated as the average of mid-year and end-of-December figures because the seasonality effects seem to be relatively strong on that item, such that the June figures were observed to understate the reality. Generally, however, all the figures presented have to be interpreted with care because they might be on the low side due to the tendency of economic activity in Tanzania to concentrate in the second half of the year (because of the predominance of agriculture). Seasonal adjustment could not be performed, however, due to absence of consistent quarterly/monthly series. Even then, the end-of-June position is not so much biased because that is the month of transition from low (first half of year) to high (second half) positions. See, for a more detailed discussion, Dabana (1980), Loxley (1966), and Rwegasira (1976).

Source: Bank of Tanzania: Economic and Operations Report, various issues.

ANNEX 8.3. Analysis of Sources of Base Money in Tanzania, 1967–81: Annual Changes (Million, TZS).

Year	Net Foreign Assets of the Central Bank		Net Claims on Government		Net Lending to Banks		Other Assets Net		Total Assets of the Central Bank	
	Value	%	Value	%	Value	%	Value	%	Value	%
1967	28.0	15.2	111.9	60.8	31.0	16.8	13.3	7.2	184.2	100.0
1968	72.8	75.0	15.1	15.6	-32.5	-33.5	-41.0	42.9	97.0	100.0
1969	-50.6	-73.9	39.9	237.1	-5.0	-17.2	-13.4	-46.0	-29.1	100.0
1970	260.5	56.9	182.8	39.9	38.5	8.4	-23.9	-5.2	457.9	100.0
1971	62.9	20.1	239.7	76.7	74.8	23.9	-64.9	-20.7	312.5	100.0
1972	111.6	62.4	121.6	68.0	-33.6	-18.8	-20.7	-11.6	178.9	100.0
1973	416.7	239.2	-125.9	-72.3	-105.8	-60.7	-10.8	-6.2	174.2	100.0
1974	-417.0	-89.2	328.0	70.2	561.2	120.1	-4.9	-1.1	467.3	100.0
1975	-196.8	-46.3	293.3	69.0	341.8	80.4	-13.0	-3.1	425.3	100.0
1976	471.8	65.9	307.5	43.0	-120.1	-16.8	56.2	7.9	715.4	100.0
1977	1003.9	66.3	-14.9	-1.0	550.9	36.4	-25.0	-1.7	1514.9	100.0
1978	-422.5	-154.0	340.4	124.1	392.8	143.2	-36.4	-13.3	274.3	100.0
1979	-770.4	-76.9	2213.0	220.9	-540.3	-53.9	99.4	9.9	1001.7	100.0
1980	-57.0	-12.7	87.9	19.6	256.1	57.0	162.6	36.1	449.6	100.0
1981	75.7	30.5	507.2	204.0	-85.4	-34.4	-248.9	-100.1	248.6	100.0

Source: Adapted from Bank of Tanzania: Economic and Operations Reports, various issues.

ANNEX 8.5. Central Bank Required and Actual Reserves (1967—81) (in million TZS).

Year	Required reserves (1)	Actual (2)	(2) — (1) (%)
1967	483.1	603.7	125.0
1968	523.8	701.1	133.8
1969	571.8	762.1	133.3
1970	573.9	841.2	146.6
1971	646.4	886.8	137.2
1972	745.5	1139.0	152.8
1973	875.3	1705.1	194.8
1974	1009.1	1167.4	115.7
1975	1303.7	789.1	60.5
1976	1618.3	1342.1	82.9
1977	1826.2	2400.5	131.4
1978	1917.6	1518.5	79.2
1979	2268.4	547.6	24.1
1980	2819.4	1079.0	38.3
1981	2682.2	835.1	31.1

Note: The required reserves have been calculated as the average sum of three-year annual imports distributed equally over four months from 1964. The actual reserves are taken as the total net position including the net official position (reserves of the Bank of Tanzania plus those of the central government) and the net reserves of the NBC at the end of June.

Source: Adapted from Bank of Tanzania: Economic and Operations Report, Various issues.

ANNEX 8.6. Outstanding Bank Borrowing by Domestic Sectors, 1966—81
(In Millions, TZS).

Years (December)	PUBLIC SECTOR			Private Sector	Total Bank Lending
	Central Government	Other official Entities	Total		
1966	99.9	12.5	112.4	782.1	894.5
1967	106.8	68.9	175.7	740.2	915.9
1968	162.9	144.5	307.4	745.8	1053.2
1969	198.2	304.7	502.9	766.6	1269.5
1970	162.6	681.2	843.8	634.1	1477.9
1971	324.7	909.3	1234.0	520.6	1754.6
1972	577.4	851.6	1429.0	629.1	2058.1
1973	766.9	1243.0	2009.9	495.1	2505.0
1974	1083.3	2207.7	3291.9	611.5	3902.5
1975	1686.2	2631.4	4317.6	642.8	4960.4
1976	2372.2	3077.3	5450.1	543.2	5993.3
1977	2084.3	3648.5	5732.8	675.0	6407.8
1978	3119.7	5005.1	8124.8	976.7	9101.5
1979	6505.6	5602.4	12108.0	1028.4	13136.4
1980	9069.9	6135.9	15205.8	1136.7	16342.5
1981	12316.2	7191.9	19508.1	1217.6	20725.7

Source: Adapted from Bank of Tanzania: Economic and Operations Report, various issues.

ANNEX 8.7. Tanzania's Currency in Circulation, Demand Deposits, Money Supply (narrowly defined), Monetary Base and the Multiplier, 1966—81 (in TZS million, except the ratios).

End of June						
Year	Currency in circulation outside banks	Demand deposits (excl. central govt.)	Money Supply (1) + (2)	Monetary Base (**)	Money Multiplier	Velocity of money circulation (*)
	(1)	(2)	(3)	(4)	(5)	(1) ./ (2)
1966	440.4	465.8	906.2	...		4.4
1967	421.6	560.0	981.6	430.4	2.3	4.1
1968	440.4	618.4	1058.8	497.2	2.1	4.0
1969	508.5	746.2	1254.7	468.1	2.7	3.6
1970	616.7	822.3	1439.0	926.0	1.6	3.7
1971	817.2	1077.7	1894.9	1238.5	1.5	3.2
1972	924.3	1128.6	2052.9	1417.4	1.4	3.2
1973	1078.2	1345.4	2423.6	1589.6	1.5	3.2
1974	1233.0	1704.1	2937.1	2056.9	1.4	3.1
1975	1423.0	2336.3	3759.3	2482.2	1.5	2.9
1976	1960.3	3016.8	4777.1	3197.6	1.5	2.7
1977	1950.9	3510.6	5461.5	3610.7	1.5	2.9
1978	2214.4	3879.9	6094.3	3884.0	1.6	2.9
1979	2846.7	5614.7	8461.4	4885.7	1.7	2.1
1980	4175.5	7174.3	11349.8	6335.3	1.8	1.7
1981	5195.1	8574.7	13769.8	5583.9	2.5	2.0

Notes: (*) See Annex 8.8 for the calculations on velocity.

(**) The monetary base is hereby defined as the currency in circulation outside banks plus central banks demand deposits less those of the central government. The fact that the monetary base was smaller than the currency in circulation during 1966—67 should be attributed to statistical discrepancies magnified by the coexistence of the Currency Board's coins and notes with those of the newly formed BOT.

Source: Adapted from the *Bank of Tanzania: Economic and Operations Report*, various years. The GDP figures were taken from *Tanzania: National Accounts* (of), 1966—80, Bureau of Statistics, Dar es Salaam 1981 (September). The 1981 GDP figure is a projection based on Finance Minister's Budget Speech 1983.

Annex Note 8.1.

Calculation of the Income Velocity of Money in Tanzania: Statistical Problems

One major statistical problem in calculating the income velocity of money for Tanzania concerns the absence of income data referring to the same time period as that for the money stock. In Tanzania, there is only one figure indicating the average rate of income during the year. On the other hand, monetary data is compiled and published at monthly intervals, from which the annual average could easily be calculated. The problem is: to what extent could the single annual income figure be regarded as a 'truly annual average'? This problem aside, there are other problems related to the income and monetary data of Tanzania.

The problem with the national income and money supply data used, is that the money supply series published by the Bank of Tanzania include both the Mainland part and the Zanzibar Islands;¹ while the available national income accounts are only those of the Mainland (see Rwegasira (1976)). Under such circumstances, one has either to estimate Zanzibar's GDP and add it to the Mainland's, or refine the money supply series published by the Bank of Tanzania to exclude the money stock due to Zanzibar. The latter alternative is extremely difficult due to the fact that the currency in circulation outside banks in Zanzibar, as well as the deposits held by the Zanzibar residents with the Mainland's National Bank of Commerce (which has one branch office on the Islands) are all unknown; although the deposits of the People's Bank of Zanzibar (the main commercial bank on the Islands, which does not operate on the Mainland) are available.

Following Rwegasira (1976), we have chosen to impute Zanzibar's monetary GDP on that of the Mainland. Our estimate of the monetary GDP for Zanzibar are based on Rwegasira's estimates, from which we have calculated the average ratio of Zanzibar's GDP to that of the Mainland for the period 1964—73, found to be 5.8 %. Given the monetary GDP for the Mainland, Zanzibar's monetary GDP is then calculated by the ratio, and added to that of the Mainland to get the total monetary GDP for the whole of Tanzania.

The other statistical problem is related to inaccuracies of the money supply data published by the Bank of Tanzania prior to 1970 (see Loxley (1971)).² The reliability of the Bank of Tanzania's estimates of currency in circulation in Tanzania during 1966—70 are therefore questionable. I have chosen to use the estimates made by Rwegasira (1976, p. 52), because these are made on the basis of the currency conversion results. In the period 1970—80, the Bank of Tanzania's data are considered relatively consistent and accurate.

The results of our calculations of income velocity of money (v) in Tanzania on the basis of data obtained in the manner discussed here are presented in Annex 8.8.

¹ There has been attempts to publish the Mainland's money supply series separately from about 1970. However, even those data remain with a Zanzibar element, as they are left with the currency in circulation outside banks in Zanzibar non-netted out, because it is unknown. Moreover, this type of data has not been published consistently enough.

² This is mainly due to the fact that during the immediate years after formation of the central bank, its new currency coexisted with that of the Currency Board, which gradually got converted from 1966—72 (see Chapter 3).

ANNEX 8.8. The Income Velocity of Money in Tanzania, 1966—80. (Values are in TZS million, v is given in units).

Year	Mainland's Monetary GDP (Curr. prices)	Estimate of Monetary GDP for the Whole Tanzania (Curr. prices) ¹	Money Supply for the Whole of Tanzania ² (M1)	Income Velocity of Money (V)
1960-64*	..	..	..	3.7
1966	4463.0	4722.0	1082.5	4.4
1967	4631.0	4900.0	1205.5	4.1
1968	4967.0	5255.0	1304.4	4.0
1969	5239.0	5543.0	1537.6	3.6
1970	5860.0	6200.0	1678.9	3.7
1971	6305.0	6671.0	2058.4	3.2
1972	7106.0	7518.0	2326.8	3.2
1973	8279.0	8759.0	2774.7	3.2
1974	10205.0	10797.0	3456.3	3.1
1975	11735.0	12416.0	4283.8	2.9
1976	13843.0	14646.0	5331.7	2.7
1977	17298.0	18301.0	6382.8	2.9
1978	18527.0	19602.0	6826.9	2.9
1979	20250.0	21425.0	10435.4	2.1
1980	21735.0	22996.0	13346.0	1.7

* Obtained from Rwegasira (1976, p. 26).

Notes: ¹ Calculated by adding Zanzibar's monetary GDP to the Mainland's Monetary GDP shown on the second column.

² For the period 1966—70, the data are from the estimates made by Rwegasira (1976, p. 52).

Source: Mainland's GDP data are from the *National Accounts of Tanzania*, various issues; while the Money Supply data for 1971—80 are from the Bank of Tanzania, Report, various issues.

ANNEX 8.9. FINANCING OF THE PARASTATAL CAPITAL REQUIREMENT (1966-77) (Million TZS).

	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977
1. TOTAL FINANCING REQUIREMENT	134.1	394.6	472.2	507.9	729.6	1217.0	997.4	1467.8	1996.7	2761.6	3864.2	2624.4
Of which:												
1.1 Fixed Capital Formation	91.4	283.3	240.9	164.8	385.6	467.5	499.0	526.4	666.1	609.2	783.4	943.7
1.2 Increase in Stock	14.0	-4.2	36.7	15.5	75.5	257.3	46.1	129.6	457.6	272.9	99.1	452.8
1.3 Net Acquisition of finan. assets	28.7	115.5	194.6	327.6	268.5	371.5	452.3	811.8	873.0	1879.5	2981.7	1227.9
2. FINANCED BY:												
2.1 Retained Profits	46.0	63.2	121.9	119.0	121.4	183.0	230.4	3281.8	299.0	550.8	561.3	788.8
2.2 Depreciation allowances	27.8	51.7	81.6	88.0	110.9	129.6	143.9	172.2	206.5	230.3	261.8	309.9
2.3 Loans from Tanzania Government	4.7	55.0	46.2	33.7	77.6	85.4	97.0	64.1	159.3	275.1	431.6	131.7
2.4 Grants from Tanzania Government	8.1	18.8	52.2	32.2	144.9	70.0	157.7	221.6	232.4	509.6	332.5	651.4
2.5 Loans from Abroad	6.6	24.2	126.2	24.6	23.7	254.5	236.5	117.4	123.4	169.3	189.6	163.3
2.6 Grants from Abroad	0.8	0.7	0.8	14.4	16.9	120.7	1.4	3.5	19.5	50.6	164.8	166.9
2.7 Domestic Borrowing	4.5	62.7	76.7	97.6	438.7	359.5	481.8	913.6	1629.3	1750.1	2823.4	2897.1
2.8 Other Sources and use of cash balances	35.6	118.3	-33.4	98.4	-204.5	14.3	-351.3	-353.4	-672.7	-774.2	-900.8	-2484.7
TOTAL	134.1	394.6	472.2	507.9	729.6	1217.0	997.4	1467.8	1996.7	2761.6	3864.2	2624.4

Note: (-) in item 2.7 implies a net increase in cash balances.

Source: 1) National Accounts of Tanzania, 1964-72; 2) Analysis of Accounts of Parastatals, 1966-77.

ANNEX 8.10. Rates of Growth of Domestic Borrowing by Government During 1966—81. (Values in Million TZS, growth rates in %).

Years	Total Domestic Govt. borrowing	Deflator (Retail or) NCP Index)	Real borrowing	Annual nominal growth rate %	Annual real growth rate %
1966/67	38.5	0.890	43.3	—	—
1967/68	191.9	0.910	210.9	398.4	387.1
1968/69	175.6	0.950	184.8	—8.5	—12.4
1969/70	480.4	0.970	495.3	173.6	168.0
1970/71	582.7	1.000	582.7	21.3	17.6
1971/72	413.3	1.047	394.7	—29.1	—32.3
1972/73	497.9	1.127	441.8	20.5	11.9
1973/74	476.9	1.245	383.1	—4.2	—13.3
1974/75	1202.0	1.484	810.0	152.0	111.4
1975/76	1281.0	1.877	682.7	—6.6	—15.7
1976/77	1495.2	2.006	745.4	16.7	9.2
1977/78	1002.5	2.238	447.9	—33.0	—39.9
1978/79	3875.3	2.493	1554.5	286.6	247.1
1979/80	3839.3	2.836	1353.7	—0.9	—12.9
1980/81	4196.9	3.694	1136.1	+9.3	—16.1

Source: Bank of Tanzania.

ANNEX 8.11. Tanzania: Public Sector—Consolidated Current Account (values in million TZS).

	1963/64	1966/67	1969/70	1972/73	1976/77	1979/80
INFLOWS						
1. Current Revenue of Central Government (C.G.)	642.8	911.5	1305.7	2105.4	4983.1	7270.0
2. Government Departmental Undertakings	17.4	34.6	53.7	50.9	79.6	
2.1 Income from operations	15.9	30.6	46.1	46.8	70.9	
2.2 Transfers (mainly from parastatals)	2.5	3.0	5.9	0.8	—	
2.3 Subsidies	—	6.7	28.3	72.6	60.5	
2.4 Rents	—	4.0	7.6	4.1	8.7	
3. Local Government Authorities	133.0	141.9	72.6	29.4	27.2	
3.1 Taxes	129.1	134.9	66.9	16.8	4.4	
3.2 Income from property	3.9	7.0	8.7	12.6	22.8	
*3.3 Transfers from C.G.	62.9	81.3	212.8	622.6	1157.6	
4. Public Non-profit Making Bodies	1.0	1.5	1.8	2.2	4.6	
4.1 Income from property	1.0	1.5	1.8	2.2	4.6	
*4.2 Transfers from C.G.	14.1	19.3	59.4	48.6	130.0	
5. Parastatals	203.2	460.7	675.8	1249.2	2434.9	4759.2*
5.1 Income from operations	20.32	460.7	675.8	1249.2	2434.9	4759.2
*5.2 Subsidies	3.5	2.3	14.2	14.1	53.8	
*5.3 Other	37.2	26.5	146.1	339.8	739.2	
TOTAL PUBLIC SECTOR INFLOWS						
(Net of transfers & subsidies) OUTGO	997.4	1550.2	2109.6	3437.1	7529.4	12029.2 +
6. Current Expenditure on goods & services	699.8	1031.4	1702.7	2995.9	6950.9	
6.1 Central Government	383.6	522.5	808.4	1401.2	3840.9	9094.0
6.2 Government Depart. undertakings	14.5	40.7	70.1	112.3	138.8	
6.3 Local Government Authorities	150.6	194.4	233.8	521.4	1196.8	
6.4 Non-profit Making Bodies	15.5	19.1	27.1	34.7	121.6	
6.5 Parastatals	135.6	254.7	563.3	926.3	1652.8	3838.2
7. Subsidies	0.6	17.6	31.9	99.7	194.1	
7.1 Central Government	0.6	17.5	31.9	99.7	194.1	
8. Transfers	212.3	278.6	334.6	516.4	431.0	
9. Other ¹	31.5	—47.8	71.7	142.0	335.4	
TOTAL OUTGO (RECURRENT EXPENDITURE)						
	944.2	1375.4	2140.9	3754.0	7911.4	12932.2 +
SECTOR POSITION (NET)	+ 53.2	174.8	—31.3	—316.9	—382.0	—903 +

ANNEX 8.12. Public Sector: Capital Account (consolidated), (current values in Million TZS).

SOURCES OF FUNDS	1963/64	1966/67	1969/70	1972/73	1976/77	1979/80
1. Surplus on Public Sector Current Account (— = deficit)	+ 53.2	174.8	—31.3	—316.9	—382.0	—903.0*
2. Capital Transfers	21.4	25.3	25.3	6.0	17.8	
3 External loans & grants	51.3	152.2	162.5	639.2	1732.3	
3.1 Central Government	51.3	127.3	121.9	518.3	1402.1	1268.0
3.2 Parastatals	—	24.9	40.6	120.9	330.2	
4. Domestic Borrowing	35.0	215.6	1038.2	1467.8	4435.5	
4.1 Central Government	34.9	79.9	377.0	268.5	1335.6	3511.8
4.2 Parastatals	0.1	136.5	661.2	1199.3	3099.9	111
5. Other Domestic Sources (recovery of loans + changes in cash balance etc.)	2.0	58.1	222.2	259.0	328.7	
TOTAL CAPITAL BUDGET REVENUE	162.9	626.0	1416.9	2055.1	6132.3	3876.0
USES OF FUNDS						
7. Gross Fixed Capital Formation	126.5	537.0	877.3	1111.8	2314.0	3873.0
7.1 Central Government	95.1	204.1	367.3	340.3	1044.7	2542.0
7.2 Government Departmental Undertakings	0.2	3.5	15.2	3.8	1.3	—
7.3 Local Government Authorities	22.4	17.6	12.1	79.8	300.7	18.0
7.4 Public Non-profit Making bodies	8.8	28.5	21.6	31.9	23.6	
7.5 Parastatals	...	283.3	461.1	656.0	943.7	1796.0
8. Purchase of Financial Assets (all subsectors total)	1.0	131.4	202.5	839.4	1304.6	...
9. Advancement of Loans	11.3	24.3	73.6	103.8	37.9	...
10. Repayment of Loans	+ 24.1	—667	+ 309.9	+ 350.1	+ 2476.6	...
11. Net changes in cash balances etc.	—	—	—46.4	—350.0	—	...
12. Other items	...	...	...	...	...	...
TOTAL CAPITAL EXPENDITURE	162.9	626.0	1479.5	2055.1	6132.3	3876.0

Source: Adapted from Tanzania: National Accounts, various issues (except for 1979/80)

Estimation of Financial Assets in Tanzania: 1950—65 (Selected Years)

Annex 8.4 provides the estimates of the financial assets outstanding at the end of the selected years during 1950—65 for the major financial institutions in Tanzania.¹ The assumptions made by the author in arriving at the estimates of each of the asset items presented for the period 1950—65 are briefly outlined below.

The Need for Estimation

With the exception of the data on the assets of the commercial banks, the Post Office Saving Banks, the Agricultural Credit Agency, the National Development Credit Agency and the National Cooperative Bank, for which figures were derived directly from the official statistics of Tanzania (mainly the Statistical Abstract of Tanganyika/Tanzania, the East African Currency Board Reports); the figures for the rest of the institutions were estimated. The need for estimation was also called forth by the fact that a majority of the financial institutions were operating on an East African basis and published their statistics on a consolidated basis, without country to country break-down, for which case one has to estimate Tanzania's share. Moreover, some of the institutions did not publish any consistent data for the relevant years.

1. *Currency in Circulation:*

Tanzania's currency in circulation has been estimated from the total monetary circulation of East Africa, published in the East African Currency Board Reports (Annual), by assuming Tanzania's share to be 38 %. This percentage is based on the results of the replacement of the old Currency Board's notes by Lake Victoria notes carried out between October 1964 and June 1966 (intended to give the currency more East African identification after political independence—Lake Victoria is shared by the three member countries).

It should be noted that the percentage share of Tanzania derived from the conversion of the East African Currency Board (EACB) notes and coins into national currencies after the creation of separate central banks, between June 1966 and December 1972, was much lower, at 32.2 % probably indicating that part of the country's monetary circulation was smuggled to the partner East Africa states for conversion. This should have been the case especially as a result of the capital flight that followed the nationalizations spearheaded by the Arusha Declaration (see Rutman (1968, p. 152)).

2. *The Land Bank of Tanganyika:*

For this institution, financial assets are estimated by the amount of loans outstanding at the end of the respective period. The 1950 figure was obtained from Dow-Smith (1952, p. 10), while those for 1955 and 1960 were obtained from the Statistical

¹ The discussion is only for the institutions for which there were no reliable data records.

Abstracts of Tanganyika/Tanzania. As discussed in the text, the Land Bank was taken over by the Agricultural Credit Agency in 1962, so that it does not show any assets for 1965.

3. The Agricultural Productivity Loan Funds:

In the absence of data on loans made by the two Agricultural Productivity Loan Funds for the period during which they existed independently (1947—60), the value of assets outstanding on these funds were estimated at the level of their initial capital. Thus, for 1960, the paid up capital of the Local Development Loan Fund (LDLF), which was the only one existing up to 1955, is taken as the base for estimation, for which it is assumed that 50 % was already loaned. The 1955 figure includes the paid up capital of the African Productivity Loan Fund, for which it is also assumed that 50 % was loaned. The estimates for 1960 are based on the IBRD Mission Report on the Development of Tanganyika (1961).

4. Cooperative Societies:

For the cooperative movement, assets issued are approximated by the sum of their capital reserves and surpluses. Figures with respect to these were obtained from Rutman (1968) and from the IBRD Report on Tanganyika (1961).

5. Marketing Boards:

Of all the marketing boards that were established in the country in the post-war years, only the Lint and Seed Marketing Board offered significant credit facilities to its members. On the basis of information provided by Rutman (1968) with respect to the reserves of the Lint and Seed Marketing Board for 1955, the figure for the other years were estimated by assuming similar rates of growth as those of the assets of the cooperative movement.

6. The statistics for the Tanganyika Development Finance Limited (TDFL), the Tanganyika Development Corporation/the National Development Corporation, the Tanganyika Finance Company (TAFCO), the Diamond Jubilee Investment Trust, the Industrial Promotion Services, the Mwananchi Development Corporation, Workers Development Corporation, and for the National Small Industries Corporation were obtained from Binhammer (1969).

Data pertaining to instalment credit institutions was derived from Pauw (1970).

8. The statistics of the lending activities of the housing finance institutions, including the First Permanent Building Society and the National Housing Corporation, were taken from Binhammer (1969) and Bienefeld and Binhammer (1969).

9. Insurance Companies:

For these, data for 1960 and 1965 were obtained from the East African Insurance Statistics Review. For 1950 and 1955, the volume of insurance premiums was estimated by assuming compound annual growth rates of 3.4 % and 2.0 % for life and non-life business respectively, which were derived from the period 1957—66.

ANNEX 9.1. TANZANIA: IMPORTANT MONETARY INDICATORS, 1954—1965

(All figures are expressed in millions EAS except where specified as %).

	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965
1. Currency in Circulation	402	455	458	458	442	432	456	446	441	504	522	466
2. Commercial Bank sight deposits	348	338	292	278	289	320	297	428	484	498	564	662
3. Money Supply narrowly defined (M1)	750	794	750	736	731	752	753	874	925	1002	1086	1128
4. Saving plus Time deposits	68	84	112	110	112	118	94	126	156	204	192	234
5. Money Supply broadly defined (M2)	818	878	862	846	843	870	847	1000	1081	1206	1278	1362
6. Monetary GDP (Current prices)	1582	1636	1786	1858	1958	2124	2454	2524	2680	3128	3824	3845
7. Price Index (1951 = 100)	118	114	112	117	123	120	121	123	122	120	121	128
8. Ratio of M2 to GDP (monetary) %	52	54	48	46	43	41	35	40	40	39	33	35
9. Ratio of Savings plus Time Deposits to mon. GDP %	4	5	6	6	6	6	4	5	6	7	5	6
10. Income Velocity of money (M1)	2.1	2.1	2.4	2.5	2.7	2.8	3.3	2.9	2.9	3.1	3.5	3.4

Source: Tanzania: Statistical Abstract, Bureau of Statistics, various issues.

ANNEX 9.2. TANZANIA: HOLDINGS OF FINANCIAL ASSETS BY MAJOR FINANCIAL INSTITUTIONS
(End of Year Estimates, values in 000 TZS)

FINANCIAL INSTITUTIONS	1950				1955				1960			
	Short	Long & Medium	Total	Short	Long & Medium	Total	Short	Long & Medium	Total	Short	Long & Medium	Total
1. EACB (Currency in Circulation)	194910	—	194910	408219	—	408219	398696	—	398696	469566	—	469566
2. Commercial Banks	316000	34000	350000	338800	85100	423900	296900	93800	390700	662600	234600	897200
3. Post Office Banks	—	35692	35692	—	52107	52107	—	32721	32721	—	33509	33509
4. The Land Bank	300	4040	4340	1260	9440	10700	4360	20380	24740	—	—	—
5. Agricultural Loan Funds	—	500	500	—	1000	1000	—	1452	1452	—	—	—
6. Agric. Credit Agency/National Dev. Credit (NDCA)	—	—	—	—	—	—	—	—	—	15300	41600	56900
7. National Cooperative Bank (NCB)	—	—	—	—	—	—	—	—	—	57100	1200	58300
8. Marketing Boards	...	...	3000	...	...	10853	...	...	30984	26000	14000	40000
9. Cooperative Societies	—	7081	7081	—	22900	22900	—	65380	65380	—	84400	84400
10. Tanganyika Finance Co.	—	—	—	—	—	—	—	—	—	—	41	41
11. Natikonal Dev. Corporation	—	—	—	—	—	—	—	—	—	—	10600	10600
12. TDFL	—	—	—	—	—	—	—	—	—	—	21500	21500
13. Mwananchi Dev. Corporation	—	—	—	—	—	—	—	—	—	—	4800	4800
14. Workers Dev. Corporation	—	—	—	—	—	—	—	—	—	—	4000	4000
15. Diamond Jubilee	—	—	—	—	—	—	—	—	—	2048	22158	24206
16. Industrial Prom. Services	—	—	—	—	—	—	—	—	—	—	5083	5083
17. Instalment Credit Inst.	—	—	—	—	—	—	—	—	—	—	15770	15770
18. National Industries Credit	—	—	—	—	—	—	—	—	—	—	2000	2000
19. First Permanent Build. Soc.	—	—	—	—	—	—	—	—	—	—	—	—
20. National Housing Corp.	—	—	—	—	—	—	—	—	—	—	18000	18000
21. National Provident Fund	—	—	—	—	—	—	—	—	—	—	36100	36100
22. Insurance Companies	—	—	—	—	—	—	—	—	—	—	29556	29556
TOTAL	526968	98295	628363	765712	191985	968550	724060	357185	1141157	1262426	576917	1841343

Source: Author's Estimates as discussed above.

ANNEX 9.3. TANZANIA: Holdings of Financial Assets by Major Financial Institutions, 1967—80. (Domestic Financial Assets by Major Financial Institutions, Nominal Values in TZS millions)

FINANCIAL INSTITUTIONS	1968	1973	1976	1978	1980
1. Central Bank (Bank of Tanzania) (Currency in circulation outside banks)	528.6	1198.6	2071.2	2915.2	5245.5
2. Commercial Banks (the NBC)	1274.6	2761.1	6860.8	9247.3	14608.3
3. Post Office Savings Bank	38.0	64.2	93.9	159.7	213.4
4. National Development Credit Agency	64.1	—	—	—	—
5. National Cooperative Bank	127.1	—	—	—	—
6. Cooperative Societies/Credit Unions	6.5	11.9	18.9	25.6	34.9
7. Tanzania Rural Development Bank (TRDB)	—	107.9	136.9	274.0	327.0
8. Tanganyika Development Finance Co. Ltd. (TDFL)	22.5	70.6	131.0	170.0	174.7
9. Tanganyika Finance Company (TAFCO)	30.0	30.0	30.0	30.0	30.0
10. National Development Corp. (NDC)	49.8	153.6	135.2	43.9	220.8
11. Mwananchi Development Corp. (MDC)	4.3	—	—	—	—
12. Workers Development Corp. (WDC)	5.0	—	—	—	—
13. Diamond Jubilee Investment Trust	27.4	35.0	40.0	45.0	50.0
14. Industrial Promotion Services (IPS)	9.9	11.0	15.8	20.0	24.0
15. Instalment Credit Institutions/ Karadha Co.	—	26.0	—	—	—
16. Tanzania Investment Bank (TIB)	—	42.1	780.4	1548.0	1663.5
17. Tanzania Permanent Housing Finance Co.	19.1	—	—	—	—
18. Tanzania Housing Bank (THB)(+ WFHDF)	—	74.1	107.8	386.7	490.0
20. The Parastatal Pension Scheme (PPS)	—	—	—	—	96.6
21. National Provident Fund (NPF)	59.7	132.7	235.7	262.0	267.3
22. National Insurance Corporation (NIC)	95.0	110.0	165.2	253.4	515.5
TOTAL	2361.6	4828.8	10822.8	15381.8	23961.5

Source: Author's estimates from data information obtained from various sources, including the Annual Reports of the respective institutions, Annual Economic Survey of Tanzania (various issues), and the Bank of Tanzania, Reports. The NDC figure relates to loans granted only.

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